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TURKEY'S BOOM YEAR | THE BATTLE OVER BEER AND DERIVATIVES

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CAN GE GET ITS JUICE BACK?

A company renowned for innovation and talent development has lost its way. Inside Jeff Immelt's quest to find the light


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Bloomberg BusinessWeek In Depth



Immelt at the Crotonville campus, a training ground for GE leaders since 1956

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COVER BY JOE ZEFF STUDIO AND ARTHUR HOCHSTEIN, (LIGHTBULB) NOERU TAKIZAWA/AMANAIMAGES/CORBIS; PHOTOGRAPH ABOVE BY BEN BAKER/REDUX

BusinessWeek The Global Report



Malone's Continental shopping spree

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Making financial literacy a civil right

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THE WEEK IN BUSINESS



JUSTIN LANE/EPA/CORBIS

ECONOMICS & POLICY

REFFING THE RECOVERY

Despite many signs that the U.S. economy is back in growth mode, the committee with the official power to declare the recession over said on Apr. 12 that, based on current data, doing so "would be premature." **The National Bureau of Economic Research**'s Business Cycle Dating Committee typically waits until it can precisely date the start or end of a contraction, a process that lags the actual peak and trough dates by about 6 to 18 months. The current recession officially began in December 2007—though it wasn't technically declared until a year later. While the committee may hesitate to call a bottom, investors have not.

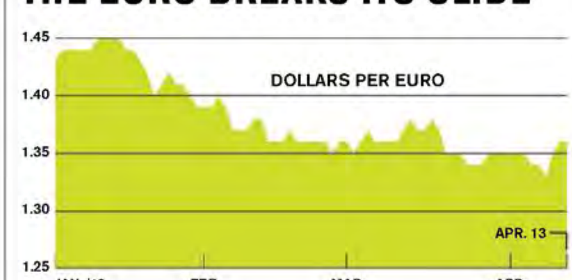
On Apr. 12, the Dow Jones industrial average closed above 11,000 for the first time since September 2008. U.S. stocks continued their ascent as the week moved forward, buoyed by better-than-expected earnings from industry bellwethers such as **Intel** and **JPMorgan Chase**. An Apr. 14 **Commerce Dept.** report showed retail sales rose 1.6% in March, the biggest advance in four months. A **Bloomberg News** survey of economists in March pegged growth in the first quarter of 2010 at 2.9%, following the fourth quarter's 5.6%.

Retail sales in March posted their biggest gain in four months

A BULWARK FOR GREECE

After months of talk, European leaders on Apr. 11 finally offered debt-ridden Greece a rescue package worth up to $61 billion contingent on need. Two-thirds of that could come from the euro zone's 16 countries, with

THE EURO BREAKS ITS SLIDE



Data: Bloomberg

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EXECUTIVE SUMMARY



Sinocrude: The Chinese are buying into oil sands in Alberta, Canada

JAKE WRIGHT/THE CANADIAN PRESS

the International Monetary Fund kicking in the rest. The assistance could come in the form of three-year loans with a 5% interest rate, well below the current yield on Greek debt. The news helped the euro rebound to a two-month high against the dollar, though Greece still needs to slash government spending to win back investor confidence.

STRATEGY

CHINA DIGS CANADA

China Petrochemical, better known as **Sinopec,** will pay $4.65 billion for **ConocoPhillips**'s stake in oil-sands producer **Syncrude Canada,** according to an Apr. 12 announcement. China is on a global quest for resources to power the world's fastest-growing economy. Mainland companies plowed a record $32 billion into mining and energy acquisitions last year. State-controlled **PetroChina** won approval from the Canadian government in December to buy a stake in **Athabasca Oil Sands'** MacKay River and Dover projects for $1.9 billion. China relied on imports to meet half of its oil needs last year.

11.7%

March increase in Chinese property prices, a record jump

Data: National Bureau of Statistics

PRIVATE ARMIES

Cerberus Capital Management, the private equity firm whose takeover of **Chrysler** ended in the carmaker's bankruptcy, agreed to buy defense contractor **DynCorp International** on Apr. 12 for about $1 billion. That amounts to a 49% premium over the Apr. 9 closing price of DynCorp's shares. DynCorp, which helps train Iraqi police and supports the U.S.'s operation of military bases, is at least the fifth government-services investment that Cerberus has made since 2000.

ANOTHER DING FOR TOYOTA

Toyota asked its Lexus dealers on Apr. 14 to stop selling the Lexus GX 460 SUV after *Consumer Reports* called the vehicle a safety risk. On Apr. 13, *CR* said that when it tested the GX 460 on a serpentine safety course, the stability control system did not kick in quickly enough. *CR*'s engineers detected the alleged flaw when they eased off the accelerator in a tight turn, causing the SUV's back end to slide outward. *CR* tagged the nearly $53,000 vehicle a rollover risk and gave it a "Don't Buy" recommendation. Toyota responded by taking the GX460 off the market while its own engineers inspect it. In January it yanked eight models from dealer lots amid claims that a sticky gas pedal caused sudden, unintended acceleration.

COCO PULLS A STUNNER

In a move that surprised network executives, jilted *Tonight Show* host **Conan O'Brien** jumped from broadcast TV to the **TBS** cable network for a late-night show that will launch in November. O'Brien, who left **NBC** in June after the network replaced him with **Jay Leno,** had been locked in negotiations with the **Fox Network.** Fox executives had been struggling to persuade its 217 affiliates to air Conan in place of lucrative late-night reruns. TBS lured O'Brien with a five-year deal that will enable him to own the show. It expects the red-haired comedian to bring a mostly younger audience that appeals to advertisers.

THE OPTIMISM METER

HOLDING STEADY



The Meter clocked in at 55 on Apr. 13, the same level as one week earlier, as a slight improvement in the outlook for housing made up for a drop in stock market enthusiasm. Some 19% of Americans believe the stock market will decline in value over the next 12 months. Developed by ***Bloomberg BusinessWeek*** using data from pollster **YouGov**, the Meter is a proprietary measure of sentiment and expectations, economic statistics, and market forecasts. It evaluates shifts in outlook among individuals, professional investors, and economists in the areas of U.S. economic growth, jobs, equity markets, and real estate.

Calculated using consumer polling, economic forecasts, and financial markets data; 0=lowest and 100=highest

Data: YouGov, *Bloomberg BusinessWeek*

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EXECUTIVE SUMMARY

LEADERSHIP

NEW BOSS AT MASTERCARD

MasterCard on Apr. 12 announced that **Ajay Banga** will be promoted to chief executive officer effective July 1, succeeding **Robert Selander**. Banga, 50, was **Citigroup**'s head for Asia-Pacific before joining MasterCard last August as president and chief operating officer. The card industry No. 2 is battling **Visa** for a bigger share of electronic payments, which are expected to account for 63% of a projected $9 trillion in U.S. consumer expenditures by 2013.



Banga will be elevated to CEO at MasterCard in July

TECHNOLOGY

PALM NEEDS A HAND



Bloomberg broke the news on Apr. 12 that Palm is shopping itself around. The company that helped pioneer the market for personal digital assistants is working with **Goldman Sachs** and **Qatalyst Partners** to find a buyer. Industry experts say Palm's most valuable assets are its WebOS software, which competes against mobile operating systems from **Apple** and **Google**, along with patents it holds. Potential bidders could include Taiwanese mobile handset maker **HTC** (page 42) and Chinese computer maker **Lenovo. Nokia, Motorola,** and **Research In Motion** might also derive a strategic benefit from a Palm acquisition. For **Elevation Partners**, the investment firm that owns about 30% of Palm, a sale would end the volatility associated with a stock that surged more than tenfold since December 2008 before erasing most of its gain.

A-TWITTER OVER ADS

Four years into its bid to upend social media, **Twitter** finally has a business model. On Apr. 13 the online service for sharing messages of 140-characters or fewer said it will start carrying "promoted tweets" from advertisers including **Best Buy** and **Starbucks**. The ads will appear at the top of search pages at the outset and will eventually be incorporated in Twitter posts more broadly.

IDEAS AN INVESTMENT WORTH TOASTING

For the ultimate in liquid investments, try top-quality wine, which has outperformed one benchmark U.S. stock index for 13 years. That's the conclusion of Philippe Masset and Jean-Philippe Weisskopf, two Switzerland-based economists who compared wine prices with the Russell 3000 Index between January 1996 and January 2009. The researchers tracked prices from 144 wine auctions with a combined value of $237 million. They used vintages from 1981 to 2005.

Masset and Weisskopf's index beat the Russell 3000 over the period, largely because wines held their value better than equities over the most recent market downturn. Since mid-2008 the wine gauge fell 17%, while stocks declined 47%. A sub-index of highest-quality wines did even better, delivering fivefold returns over the 13-year period, vs. a 50% gain for the Russell 3000.

Demand for alternative investments such as wine and artwork has grown as investors seek refuge from inflation and look for asset classes in which to store wealth beyond the traditional choices of stocks, bonds and gold. "My wine cellars have probably appreciated better than any other investment I have made personally," says Drew Nieporent, owner of New York restaurants Corton, Nobu, and Tribeca Grill.

Raise Your Glass: Wine Invesment and the Financial Crisis



Readying a Melchoir (18 liters) of Chateau Cheval Blanc for auction

(BOTTOM) FIONA HANSON/PA/AP PHOTO















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DELL

AT THE TABLE CHARLIE ROSE





(FROM TOP) BRAD TRENT; VIVEK PRAKASH/REUTERS

PRIME MINISTER LEE HSIEN LOONG
The View from Singapore

On Apr. 14, the day after leaders of 47 nations gathered for the Nuclear Security Summit in Washington, I talked with Singapore Prime Minister Lee Hsien Loong about the threat of nuclear proliferation, currency revaluation (Singapore revalued on the same day), and China's state of mind.

CHARLIE ROSE

What was accomplished at this summit?

PRIME MINISTER LEE

Nuclear security is not something you can solve overnight, but it's a real problem, and if you don't do something about it, sometime, someplace, something disastrous will happen. President Obama managed to get many leaders together, focus their minds on securing nuclear materials, and [persuade them to] commit to further steps to make the world a safer place.

How much of the talk was about Iran?
We didn't explicitly discuss Iran, but obviously Iran is one of the concerns.

What can be done about North Korea and nuclear weapons?
You have the six-party talks. You have to keep on talking and engaging them. The saving grace is that the Chinese do not want the North Koreans to have nuclear weapons.

They already have them.
But the Chinese disapprove, and this is something which the Koreans have to take into account. For the [North

Korean] regime, it's an existential thing. So the regime is not going to give up lightly because this is the way they make sure nobody is going to cause regime change.

Now, everybody wants China to let its currency rise. Are you prepared to urge Beijing to do that?
The [Chinese] are running a trade surplus. Their exports are booming. If they allow the currency to rise, it may raise costs some, but it will at the same time diminish some inflationary pressures. And it's part of the adjustment as they become more productive and as their standard of living goes up. I think they should revert to where they were before the financial crisis and allow the yuan to go up gently again.

You know the Chinese mind. People say they do not want the West, especially, to pressure them.
I don't think it's just the Chinese. No country wants to be pressured. Ask Benjamin Netanyahu or any other leader; you have to have a certain courtesy and respect and restraint.

Did the U.S. hurt its relationship with China because of aircraft sales to Taiwan and receiving the Dalai Lama?
Well, you have to do what you have to do and make your own calculations. But these are not issues that you could expect to be received with acclaim in Beijing. If you want to cross them, do not do so without thinking about it.

[THE CHINESE] ARE TRYING TO CALIBRATE THEIR POSITION AS THEY BECOME ECONOMICALLY MUCH MORE POWERFUL

People were pleased China came to this summit because there was a feeling it was being more aggressive toward the U.S.
I think they are trying to calibrate their position as they become economically much more powerful. You have to decide how to trade off your interests, maximizing for yourself, versus the interest of the whole system and your long-term requirement to be a constructive player in the world system, which is what America has done since the Second World War. After 60, 70 years in Asia, people still say America plays an indispensable role to this day. It would be quite something if the Chinese could achieve that.

How is the upcoming generation of Chinese leaders different from those they succeeded?
The current generation of leaders experienced a cultural revolution. They know what a mess China can be if it is mismanaged and how important it is for China to grow and improve the lives of its people. The next, or maybe the next-next group of leaders will be post-cultural-revolution. They will have grown up in 30 years of reform and opening up. They will have lived in a China that is connected through the Internet with people who are much better informed about what's going on in the world. And they will have to run this whole system not as a central system but with a market economy and a coherent political framework on top of that. I think they will have a big challenge.

What worries Chinese leaders?
Instability.



Protesters in Seoul rally against North Korean nuclear tests in 2009

They've seen Tiananmen, and they saw the Falun Gong.
[Members of the Falun Gong] appeared as a flash mob one day in front of the inner sanctum. That was the first [the leadership] ever heard of Falun Gong, and it scared the daylights out of them. And when they discovered who was in the Falun Gong and how many senior officials had joined this secret group, they were really shaken.

Could China have become what it has without the system it had?
There is a phrase in China that the mountains are high and the emperor is far away. You can give any orders you like out of Shanghai [or] Beijing, but far away in the provinces your governor does what he wants. So for them to have gotten the whole country moving in this way, not micromanaged and centrally directed but with all of its own centers of growth and dynamism, that's remarkable.

Do they want to be part of the existing international system?
Yes, but they would like to have their share of the sunshine. They will tell you that they have 1.3 billion people, and each one is entitled to so many kilograms of carbon dioxide. |BW|

Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

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BUSINESS OUTLOOK | RICH MILLER AND ANTHONY FELD

KEY TO RECOVERY: RESTOCKING ALL THOSE SHELVES

With employment weak and credit tight, worries persist about the possibility of a double-dip recession. But inventory rebuilding should help keep the economy strengthening

What indicator is former Federal Reserve Chairman Alan Greenspan following most closely these days? No, it's not consumption, business investment, or even the jobs market. It's inventories. "That's a peculiar thing to say," the 84-year-old economist admitted in a Bloomberg Television interview on Mar. 26. But "inventories are critical now."

Companies slashed stockpiles by a record amount last year as demand for their products nosedived. That aggressive destocking aggravated the downturn and helped make the decline the deepest since the 1930s. In fact, corporate shedding of inventories accounted for almost a third of the 2.4% contraction in the American economy last year.

Now, with the economy showing signs of recovering and sales picking up, the reverse dynamic is about to set in. Companies from luxury retailer Tiffany to Home Depot are starting to restock their shelves. That should give a fillip to U.S. growth and help keep the recovery on track throughout the year.

The shift is already affecting the economy's bottom line. More than two-thirds of the 5.6% annualized growth of gross domestic product in the fourth quarter of last year came from inventories, the biggest kick from that source since 1987.

15%

Odds of a double-dip recession in an early-April survey of 46 economists

Data: Bloomberg News

And there's more to come. David Hensley, an economist at JPMorgan Chase in New York, says inventories will boost gross domestic product in the first three quarters of this year as well, though not to the same degree as in the final three months of 2009. Manufacturing companies added to stockpiles in March for the first time in almost four years, according to a survey of purchasing managers by the Institute for Supply Management. Ten of 13 industries, including clothing makers and computer producers, reported higher inventories.

Companies are restocking because they're finding themselves short of product as sales strengthen. The ratio of business inventories to sales was 1.27 in February, just above a 29-year low of 1.24 set in 2006 and down from a recession high of 1.46 in January 2009. The ratio averaged 1.3 in the last economic expansion, from 2001 to 2007.

Businesses are also adding to their supplies because it's taking longer to get the materials they need to run their plants. Manufacturers reported that deliveries from suppliers slowed in March, according to an index compiled by ISM. The index rose to a more than five-year high of 64.9 last month from 61.1 in February. The higher the index, the more widespread is the slowdown in deliveries.

The turn of the inventory cycle isn't just occurring in the U.S. Companies in Europe and Asia also have been surprised by the recent strength of their sales, according to Hensley, and are starting to add to their stockpiles.

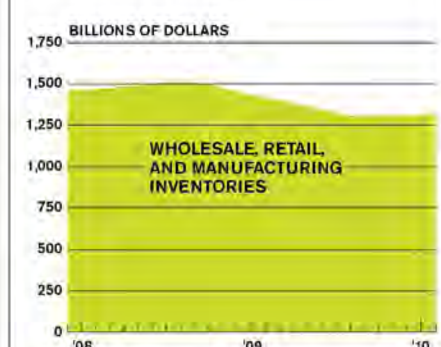
Such restocking will not only boost GDP in the U.S. and elsewhere but also spur hiring as manufacturers ramp up production to meet increased demand. Manufacturing payrolls in the U.S. rose in March for the third consecutive month, something that hasn't happened since 2006.

The danger, of course, is that sales won't increase as much as companies expect, leaving them with more workers and inventory than they need and raising the risk of a relapse in the economy later this year. That's one reason the committee at the National Bureau of Economic Research responsible for determining when recessions begin and end cautions that it's premature to declare an end to the current slump.

Indeed, Martin Feldstein, a Harvard University professor and NBER committee member, still sees a "significant risk" of a double-dip recession. "The consumer is going to have a very hard time," he said. "Unemployment remains an enormous problem."

Greenspan is not nearly so pessimistic. He says the odds that the U.S. will tumble back into recession "have fallen very significantly in the last two months" and forecasts a "self-reinforcing" cycle of industry replenishment that will carry the economy forward. For now, that seems the better bet. |BW|

SINKING INVENTORIES ARE POISED TO RISE



Data: U.S. Commerce Dept.

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How Do You Say Bubble Trouble in Chinese?

With a white-hot property market and double-digit growth, China's overheated economy may be heading for trouble. Why Beijing needs to act—and fast

By Dexter Roberts

Early in 2009, when the Dow Jones industrial average hovered at 6,500 and economies in the U.S., Japan, and Britain were contracting, China revved its economy. The country's central bank opened the monetary floodgates while financial authorities ordered state-owned banks to crank up lending. A $586 billion stimulus package assembled by Chinese President Hu Jintao's government in late 2008 sent even more money flowing to large state-controlled construction and energy companies.

As a result, the Chinese economy helped propel global growth—and now runs the risk of overheating. The government was expected to announce on Apr. 15 that the economy expanded at about a 12% rate in the first quarter vs. 8.7% in 2009, the fastest pace in almost three years. Property bubbles in major Chinese cities such as Shanghai and Shenzhen and a 22.5% jump in March in the broadest measure of money supply (M2) are ominous signs. "China's economy clearly needs to be slowed down," says Isaac R. Souede, chairman and CEO of Permal Asset Management, a hedge fund that manages $20 billion globally. "The critical question is whether it will be [a] soft or hard landing." Adds Dell China President Amit Midha: "The government took bold, decisive, and swift action to stem the effects of the financial crisis. Now the concern is the recovery may be too fast."

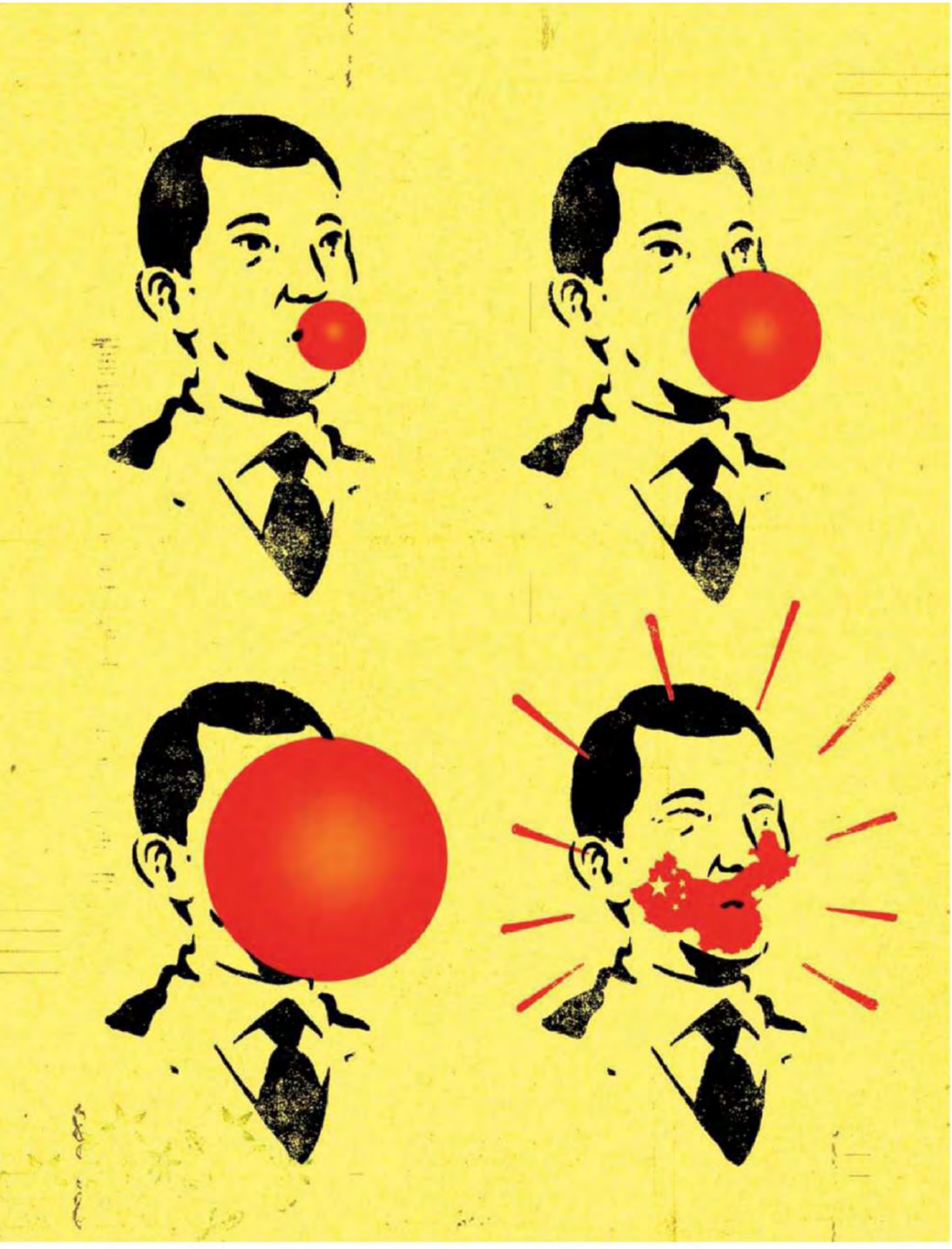
China's hybrid economy, in which elements of free markets coexist with a one-party state that has a huge say over how credit is allocated, is about to be put to an interesting test. Can Beijing really slow a complex, $4.9 trillion economy when so much of its political power comes from, well, delivering high-speed growth rates?

CAN CHINA REALLY SLOW A $4.9 TRILLION ECONOMY WHEN IT DEPENDS ON HIGH-SPEED GROWTH TO GENERATE JOBS?

Shrewd players within the government, such as Premier Wen Jiabao, People's Bank of China Governor Zhou Xiaochuan, and Chinese banking regulator Liu Mingkang, have signaled their willingness to cool the economy. Yet austerity is a tough sell in a country that needs growth rates of about 8% to generate jobs for 10 million Chinese who enter the workforce every year.

After diplomatic nudging from U.S. Treasury Secretary Timothy F. Geithner, Beijing may ease the yuan's peg to the U.S. dollar by further widening a trading band that would result in modest appreciation. Yet China is a long way from letting the yuan trade freely against foreign currencies or lifting restrictions on the flow of capital in

ILLUSTRATION BY RICHARD MIA





Chasing People's Bank of China Governor Zhou for news on currency policy

and out of the country by citizens and companies. And the currency debate is just one facet of the gargantuan effort China faces to resolve the structural issues bedeviling its economy. Liberalizing its currency will be much easier when domestic demand, now representing only 36% of GDP, rises to the 50% level typical of other emerging economies. "We must develop the economy mainly by relying on the domestic market," said Vice-President Xi Jinping on Apr. 10 at the annual Boao Forum on China, an economic conference on the southern island of Hainan.

Domestic consumption won't grow until China frees up its tightly regulated service sectors and allows more funding to flow to job-creating small and midsize enterprises. Also key: lowering health-care costs and taxes on China's middle-income consumers, argues Chinese economist Fan Gang. "China must increase the spending power of its middle class," says Fan.

In the corporate world, state-run steel, auto, and telecom companies get a disproportionate share of credit from government-controlled banks. "State-owned enterprises still dominate the economy, and the private sector has no access to some sectors," says Fred Hu, managing director and chairman of Greater China for Goldman Sachs. "In order to unleash the power of China's economy as a whole, we have to be committed to deregulation [and allowing more private companies to compete]."

Local governments wield considerable power and can also easily tap the regional branches of government-controlled banks for quick loans. The head of the China Banking Regulatory Commission, Liu, is pushing the nation's banks to submit reviews of their loan books by the end of June, in part to get a handle on lending to locally controlled government investment vehicles for pet investment projects, a contributing factor to the overheating economy. "Better lending guidance is necessary to prevent potential financial risks to avoid bad loans emerging from property lending or local-government borrowings," says Lu Ting, a Hong Kong-based economist at Bank of America Merrill Lynch.

Beijing is making some headway in getting its state-run banks to lend less. Following two moves by the People's Bank of China requiring lenders to place more money with the central bank as reserves, new-loan growth fell 27% in March from the previous month. Interest rate hikes could be coming soon as well, since the consumer price inflation rate for March is forecast to hit a 16-month high of 2.6% when the number is released. Still, the government isn't dramatically cutting state-supplied credit. This year's loan target, although down considerably from last year, is still more than 50% higher than that of 2008.

Geithner and European trade officials have argued that letting the yuan appreciate more is enlightened self-interest. A stronger yuan would effectively lower the price of foreign currency-denominated imported products such as oil, cars, and wheat. A revaluation and stronger Chinese currency would counter the "risk of considerable overheating in the economy," says former European Union Trade Commissioner Leon Brittan, now vice-chairman of UBS Investment Bank.

Chinese leaders instinctively recoil when they feel pressured by foreign governments to free the yuan. Yet Hu's government will need to come up with some policies to throttle the economy this year or risk a crash in property prices that would have social and political ramifications. And make no mistake: A crisis in China would hit trade flows in Asia, rock commodity exporting nations such as Australia and Brazil, and even hurt rich world economies like the U.S., Japan, and Europe just as they are starting to emerge from severe recessions. Much is riding on how well Chinese leaders turn down the economic thermostat. |BW|

–With John Liu, Michael Forsythe, and Yidi Zhao

UNEVEN IMPACT

The effects of a stronger yuan will not be uniform across the mainland:

LOSERS

Exporters lose out because their costs for labor, land, and other inputs (except imported components) are denominated in yuan while most of their revenues are in dollars. Companies with plentiful international assets, without corresponding levels of foreign debt, will take a hit.

Wealthy mainlanders who have money stashed away in foreign banks will see the value of their holdings shrink.

WINNERS

Chinese consumers, from the Beijing family planning a trip to San Francisco this summer to the Shanghai teenager with a hankering for a pair of Nikes, stand to benefit.

Businesses that serve the domestic market—steel mills that buy Brazilian iron ore to make I-beams, boutiques that stock foreign fashions—win because their cost of imports will fall.

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The Home-Equity Hurt Ahead for Banks

Bad second mortgages are about to batter earnings and slow efforts to resolve the foreclosure crisis

By Dakin Campbell and David Henry

Bank shareholders have reason to be pleased. On Apr. 14, JPMorgan Chase, the first major bank to report first-quarter earnings, beat analysts' estimates with a 55% gain. The 24-company KBW Bank Index jumped 22% in the first three months of this year, more than four times the 4.9% gain of the Standard & Poor's 500-stock index. Investors have pushed up the price of financial stocks in the belief that the biggest loan losses are in the past and banks will begin to restore dividend payments and buy back shares.

Their party may be premature. Banks are sitting on a problem that won't show up in the current round of earnings reports but has the power to stall the bank rally and economic recovery as well: bad home-equity loans.

An analysis by CreditSights, a New York research firm, shows that the four biggest banks by assets—Bank of America, JPMorgan Chase, Citigroup, and Wells Fargo—may need to set aside an extra $33.2 billion to cover additional losses on home-equity loans that could begin hitting their balance sheets later this year. That amount is almost equal to what analysts expect the four banks to earn in 2010.

The four companies hold $442 billion of the nation's $1.1 trillion in second-lien mortgage loans, according to Amherst Securities Group, an Austin (Tex.) firm that analyzes home loans.

JPMorgan CEO Jamie Dimon told investors earlier in the year that his bank's quarterly writedowns for home-equity lending this year "could reach $1.4 billion." While the bank wrote down $1.1 billion of home-equity loans in the first quarter, in a conference call Dimon cited "uncertainty" about the rest of 2010.

The losses mean bank earnings "are going to be very disappointing for a while," says R. Christopher Whalen, managing director of Torrance (Calif.)-based Institutional Risk Analytics. "That's bad news for people who are long financials because they bought into this momentum play, and yet the fundamentals at the banks are still deteriorating."

55%

JPMorgan Chase's profit gain for the first quarter, topping forecasts

Data: Bloomberg

Bad home-equity loans are getting in the way of reworking homeowners' debts and easing the foreclosure crisis. That's because in many cases first mortgages can't be modified or written down unless junior loans are erased first. Yet few lenders have agreed to reduce or forgive home-equity loans when modifying mortgages, even if a property is worth less than what's owed, according to a report by Troubled Asset Relief Program Special Inspector General Neil M. Barofsky.

Last month House Financial Services Committee Chairman Barney Frank (D-Mass.) sent a letter asking banks to recognize more losses to clear the way for mortgage modifications. "Large numbers of these second liens have no real economic value—the first liens are well underwater and the prospect for any real return on the seconds is negligible," Frank wrote.

That may be so, but banks have been slow to take writedowns on second liens because many borrowers keep paying even if their primary mortgage is underwater. According to Bank of America CEO Brian T. Moynihan, 80% of home-equity borrowers who owe more than 100% of the value of their homes continue to pay on time and in full. At a hearing Frank held on Apr. 13 in Washington dealing with the issue of second-lien mortgages, the four big banks said their foreclosure prevention efforts are working and discouraged plans that would force them to reduce mortgage debt for distressed homeowners.

So home-equity loans seem likely to bedevil banks, homeowners, and the economy for some time. "The banks are saying that they can work through it," says Baylor A. Lancaster, senior bank analyst at CreditSights. "Our view is that [the problem] may be bigger than they are letting on." |BW|

ILLUSTRATION BY DAN PAGE



STEPHEN VOSS/REDUX

Stern at his Washington office wearing purple, the SEIU's official color

What Andy Stern Leaves Behind

He built the SEIU into a potent political force, but did he really recharge the labor movement?

By Holly Rosenkrantz

It will be a long time before the labor movement produces another leader quite as far-seeing as Andrew L. Stern, who stepped down Apr. 14 as president of the Service Employees International Union. Or one quite so controversial.

During his 14 years atop the SEIU, Stern turned it into a potent political force. He used its might to shape policy and ultimately help determine the outcome of the 2008 elections. Funneling more than $70 million into the campaign coffers of Barack Obama and other Democrats, the SEIU outspent even the U.S. Chamber of Commerce.

SEIU became the country's fastest-growing labor union, doubling its size to 2.2 million, mostly by organizing state and local employees, janitors, and health-care workers. "He organized workers at the lowest rungs who had been ignored, workers like immigrants," says Harley Shaiken, a labor professor at the University of California at Berkeley. "He transformed a whole class of jobs—from janitors to home health-care workers to nursing home workers—into middle-class jobs by helping them unionize and negotiate contracts."

Stern, 59, stood out among his fellow union officials, many of whom had worked their way up from coal mines or factory floors. Armed with an Ivy League education, Stern recognized early on what other union leaders didn't want to see: that the AFL-CIO's membership was both dwindling and aging. While others worked to preserve the gains of manufacturing workers in auto and steel plants, Stern foresaw a shift in the country's economic landscape. He fought to shift gears and organize service workers to replace the labor movement's thinning ranks.

That led to Stern's most controversial move, his 2005 secession from the AFL-CIO with seven unions in tow. His formation of a rival federation led many to compare him to John L. Lewis, the Depression-era miners' leader famous for his aggressive organizing and contentious style.

Some in the labor movement never forgave him and insist that Stern has left it weaker. Private-sector union numbers in the U.S. fell to a record low of 7.2% of the workforce last year, and two unions have quit Stern's breakaway group. "He has disregarded democracy and made secret deals with employers that adversely affects SEIU members and the patients they take care of," says Sal Rosselli, a former SEIU leader in California who created a rival health-care union. "The labor movement is absolutely weaker because he has used his influence for his own personal political gain."

7.2%

Percentage of U.S. workforce that was unionized in 2009, down from 10% in '96

120%

Increase in the membership of the Services Employees International Union between 1996 and 2000

Data: unionstats.com, SEIU

Robert Bruno, a labor professor at the University of Illinois in Chicago, says that Stern's labor federation "never evolved into something really new and independent to transform the labor movement."

That said, the results of his strong-willed leadership will be felt even by Americans who have never belonged to a union. Stern was the most frequent outside visitor to the White House in the first six months of President Obama's tenure. Administration officials say he helped shape the strategy that ultimately won passage of the health-care overhaul legislation.

Now, with 30 million Americans about to become newly insured, the health-care industry is almost certain to mushroom. And the SEIU will be ready to organize its new employees. |BW|



Italy's Enel has received $61 million in U.S. subsidies and hopes to get more

A Gold Rush In Green Technology

On tap, a slew of IPOs from clean energy companies, many of them subsidized—at least for now

By Mark Scott and Alex Morales

Like bright sunshine charging up solar panels, investor fervor is fueling the market for public offerings of green companies. Electric automaker Tesla Motors, U.S. green energy producer Ameresco, and Spain's T-Solar have filed to go public, and many more are waiting in the wings. "There's renewed appetite for green IPOs," says Luigi Ferraris, chief financial officer of Italian utility Enel, which plans to sell a minority stake of its renewables subsidiary Enel Green Power for $5.4 billion by the end of the year. That would be Europe's largest listing since 2007.

Green companies have said they hope to raise $9.6 billion worldwide, according to Bloomberg New Energy Finance. That's more than triple the total for eco-IPOs during all of last year. Renewable energy projects such as wind farms and solar parks still garner the most interest, but energy conservation and water management are also winning financial backing.

British solar energy producer Engyco wants to secure $1.4 billion, while its Madrid-based rival Renovalia could raise more than $300 million. Indian clean-tech manufacturer Indosolar aims to raise $88 million in Mumbai. San Diego-based Fallbrook Technologies, a maker of efficient transmissions for vehicles, is looking for $50 million. And Tesla is aiming for $100 million. "Investment bankers are out there soliciting business," says Nigel Meir of Ludgate Environmental Fund in London, which invests in clean technology companies. "The green sector has a lot of forward propulsion."

$9.6 billion

Value of green technology IPOs expected this year

Data: Bloomberg New Energy Finance

Some of the fuel is coming from national governments around the world, which have earmarked billions to fund renewable energy installations and projects such as modernizing the electricity network. Climate change regulation could also help eco-firms lock in revenues from customers required to reduce their carbon footprint. "A big part of the renewables market is the stimulus provided by governments," says Chris Thiele, a Morgan Stanley investment banker in London.

Some worry that the rapid flow of state funding may end as abruptly as it started. Governments, particularly in cash-strapped European countries, face growing deficits. Costly green initiatives such as cheap loans for homeowners who install solar panels could be cut by politicians reluctant to curb spending on, say, health care or defense. Subsidies "are at the whim of whichever party is sitting in power," says Walter Nasdeo of Ardour Capital Investments, a New York investment bank that specializes in clean technology.

Concerns over government cutbacks haven't stopped Enel Green Power. The company has secured $61 million in U.S. stimulus money for two geothermal power plants in Nevada, and hopes to land further millions in federal support for American wind, solar, and geothermal projects. "The U.S. offers a huge opportunity for growth," says Ferraris. In its home market, the Rome-based utility benefits from rules that let it charge customers above-market prices for energy from renewable sources. All told, Enel Green Power plans to invest $6.9 billion in renewables across three continents by 2014. The IPO money will help pay down its parent company's $69 billion debt.

Before the fiscal crisis, even companies with few customers and unproven equipment could get funding. These days, steady sales from proven technology are a must—something virtually all the companies looking to list now have. "People once backed hope," says Stephen Mahon, chief investment officer at Low Carbon Investors in London. "Now they back revenues." |BW|

ROBERTO CACCURI/ENEL

Malone's New Run At the Old World

Despite years of losses in Europe, the King of Cable has a $4 billion war chest and is ready to buy



Malone hopes to convert 10 million analog customers to costlier digital service

By Ragnhild Kjetland and Brett Pulley

Two decades ago, John C. Malone tried and failed to replicate his U.S. cable TV success in Europe by buying up local carriers. Now, despite losing money in his international cable operations in all but two of the past 16 years, the 69-year-old King of Cable is ready to try again.

In January, Malone's Liberty Global bought Germany's No. 2 cable operator, Unitymedia, for $2.7 billion. With nearly $4 billion in cash from the sale of a Japanese subsidiary in February, Liberty is looking for other European opportunities as well. It may bid on Germany's No. 3 cable operator, Kabel Baden-Württemberg, and Aster City Cable in Poland, company executives say. Malone could also try to acquire carriers in France, Sweden, and Denmark, says Guy Bisson, an analyst at media researcher Screen Digest. With many rivals interested in the same properties, "It's a race," says Manuel Kohnstamm, Liberty's managing director of public policy.

The winner stands to dominate newer digital technologies, both on-demand TV programming and Internet access. Though just one-third of European pay-TV subscribers have digital service, they currently generate half of all revenues, according to Cable Europe, an industry group. European homes with digital cable are projected to more than double, to 46 million, by 2014, Screen Digest estimates. Of those customers, some 41% will use their cable connection for Internet service, up from 31% today.

$20

Average that German cable subscribers spend monthly, vs. $119 in the U.S.

Data: Bloomberg, SNL Kagan

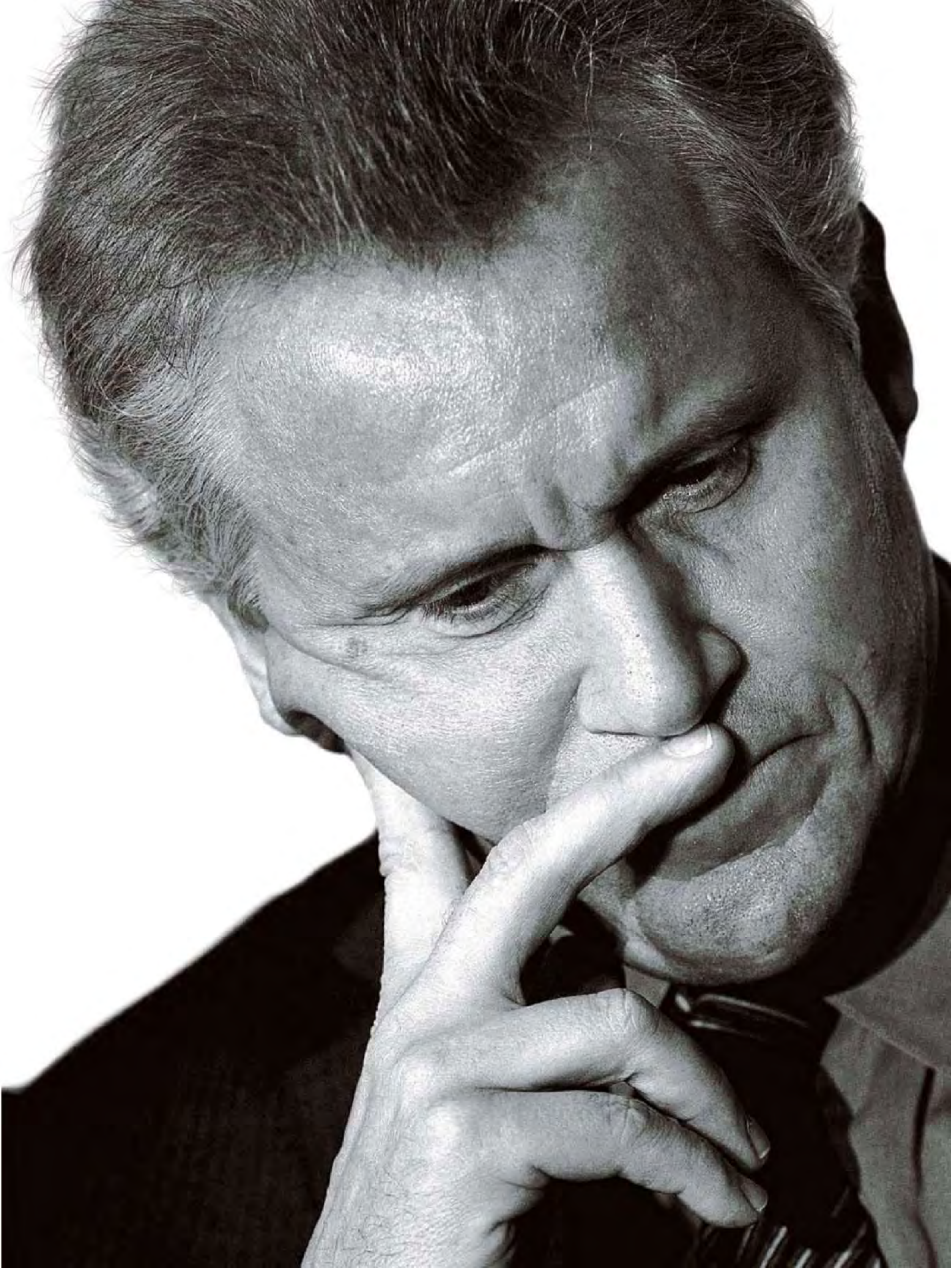
Malone sold his American cable business to AT&T in 1996 for $54 billion. Today his U.S.-based flagship, Liberty Media, owns TV shopping channel QVC, the Starz pay-TV channels, and stakes in Sprint Nextel, Sirius XM Radio, and Time Warner. Liberty Global has 16 million cable subscribers in Europe, but fewer than two in five are digital. With the addition of UnityMedia it now has operations in 11 European countries. Last year, before the acquisition, the company's European arm had sales of $6.2 billion.

For Liberty's latest foray to pay off, the company must get subscribers to shell out more for programming. When it comes to paying for TV, Europeans are famously cheap. In Germany, for instance, the average monthly revenue per subscriber is about $20, vs. $119 in the U.S. Now, Liberty aims to convert its millions of analog customers to costlier digital service. "We have 10 million [subscribers] that have yet to make the decision 'Maybe we want 150 channels, maybe HD would look good in my living room,'" says Michael T. Fries, Liberty Global's CEO. "So we have 10 million untapped homes that we are running as fast as we can to connect."

Even if Fries is successful, cable in Europe is unlikely to become the money spinner for Malone that it was in the U.S. two decades ago. Sure, Liberty will likely benefit from cheaper prices as it buys greater quantities of equipment and programming. But differences in languages, laws, and tastes make it difficult to gain the cost efficiencies that made Malone's consolidation of the American market so profitable. A bullfight finds few viewers in the Netherlands, for instance, while a speed-skating championship that's a hit with the Dutch gets a yawn from Spaniards. Ads aimed at children are barred in Sweden but allowed elsewhere. France, meanwhile, bans liquor spots, while they're permitted in Germany and Italy—but at different times of day.

Malone has called cable the "best wealth creation model" he knows. As he makes another run at Europe, he may find that's no longer the case. |BW|

PETER FOLEY/LANDOV



By Diane Brady

Photograph by Mark Lennihan

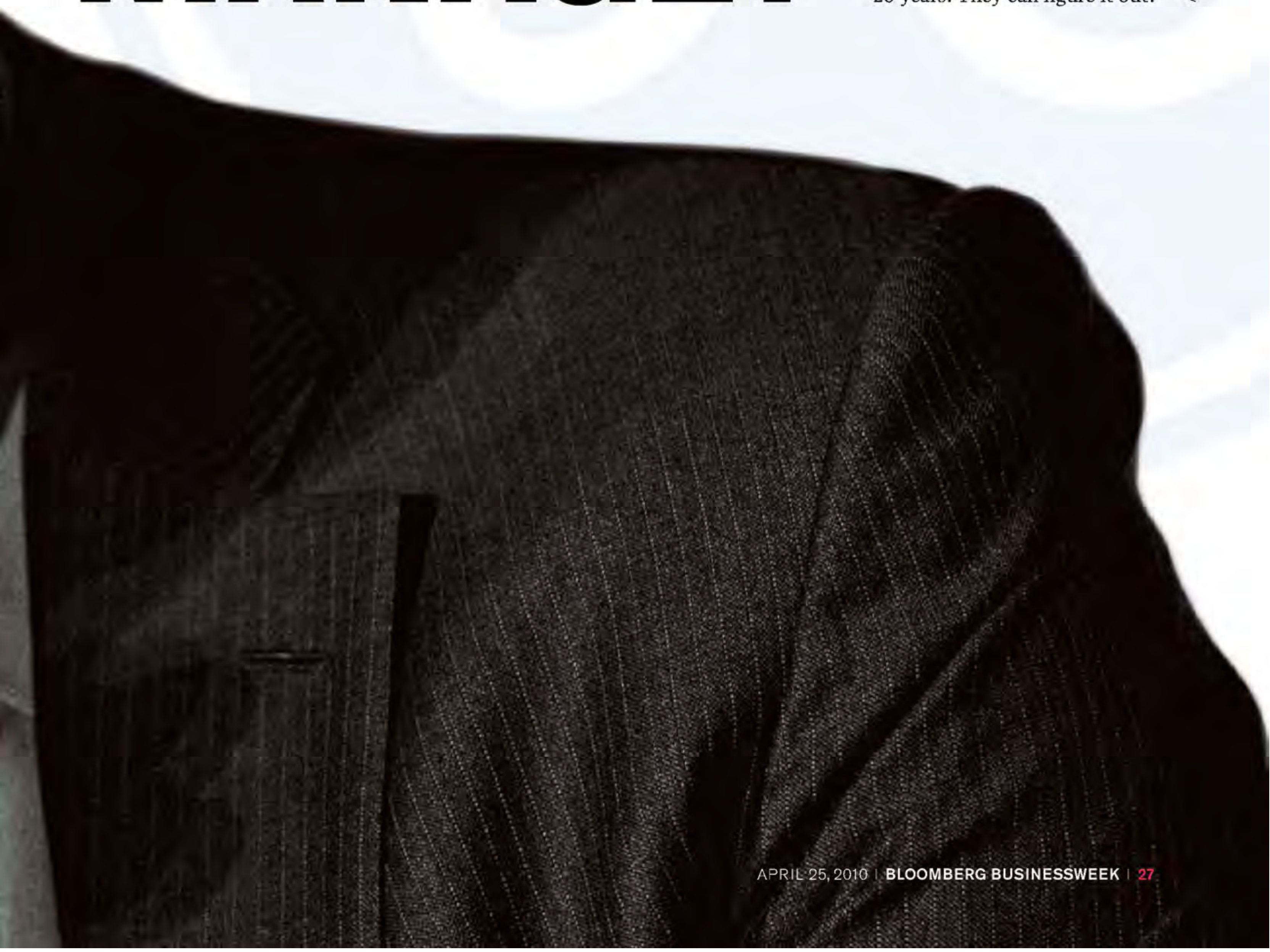
CEO Jeff Immelt says his company trains the best business leaders in the world. Yet they haven't saved him from a hellish decade that cut GE's value in half

CAN GE STILL MANAGE?

A couple of Fridays each month, Jeffrey R. Immelt hosts a sleepover. The chairman and CEO of General Electric invites one of the 185 officers of his company—and only one—to his home in New Canaan, Conn., for a leisurely meal. After a few drinks, some laughs, a plate of pasta, and a wide-ranging discussion of what's going on in the world, the two executives part. Immelt, 54, stays home while his guest heads to lodging at GE headquarters in nearby Fairfield. When they reconvene the next morning, things get personal. "We spend Saturday morning just talking about their careers," says Immelt. "Who they are, how they fit, how I see their strengths and weaknesses—stuff like that." One recent guest, Steve Bolze, president and CEO of GE Power & Water, calls it "a really nice discussion, a chance to get to know each other better."

What does it say about Immelt that after almost a decade in the top job he's looking for ways to bond with his team? "The personal connection is something I may have taken for granted before that I don't want to ever take for granted again," he says. "Sometimes there's a tendency to say, 'Well, this is an officer of the company. They've been here 20 years. They can figure it out.

AP PHOTO



SINCE 1956, GE'S MANAGEMENT INSTITUTE AT CROTONVILLE HAS LOOMED LARGE INSIDE THE COMPANY, AND AN INVITATION THERE REMAINS A SIGN THAT AN EXECUTIVE IS BEING GROOMED



Do they really need me to draw them a diagram?' But you need to make the time."

The sleepovers are part of a major rethink by Immelt, a personal reevaluation of how GE equips its people to lead. The reappraisal was triggered by the global financial crisis, which shook the $157 billion-a-year conglomerate, almost destroyed its financial services unit, and sent its share price from $29 in the days before Lehman Brothers crashed to below $6. (It has since recovered to around $19, leaving GE's market cap, at roughly $200 billion, about half what it once was.) That led Immelt to become what he describes as "self-reflective on steroids" and to ask a hard question: "Was there one of my top 150 people who was thinking, 'You know, Jeff, commercial real estate shouldn't be so goddamn big,' but didn't have a way to say [it]?"

Immelt intends to spend this year exploring new ideas, which he describes as "wallowing in it," to decide how GE should shape and measure its leaders. He has solicited management suggestions from a broad range of organizations—from Google to China's Communist Party—and sent 30 of his top people to more than 100 companies worldwide. He's holding monthly dinners with 10 executives and an external "thought leader" to debate leadership. He launched a pilot program to bring in personal coaches for high-potential talent, a practice that GE once reserved mainly for those in need of remedial work. To increase exposure to the world beyond GE, Immelt is even reconsidering the age-old rule that employees can't sit on corporate boards. "I think about it all the time," he says. "You have to be willing to change when it makes sense."

To see GE openly scrutinize its leadership approach is a bit like watching Oprah take talk-show lessons. Despite questions about GE's ho-hum results (earnings from continuing operations sank 38% in 2009 and are expected to stay flat this year) and the familiar calls to break up the conglomerate, creating leaders is one area where GE's reputation remains unparalleled. Year after year the world sees it as the gold standard for talent. In a recent global survey of the best companies for leadership by Hay Group, GE ranked No. 1.

At a time when many view training as a burdensome cost center, GE continues to treat human resources as a sacred art, spending $1 billion a year on training and devoting weeks or months of each year to evaluating talent. Immelt spends a big chunk of April on little else. "Their investment is formidable," says Brooks C. Holtom, a management professor at Georgetown University's McDonough School of Business. "The bench is widely viewed as one of the deepest in the world."

Yet there's a growing sense that something's not right—and not just because of the "decade from hell" that Immelt wrote about in this year's annual shareholder letter, which concluded that "GE must change" to thrive in the new era. (Amid the crisis, he has cut the dividend and laid off 10% of his workforce while forgoing his own bonus

GE'S TALENT TOOL KIT

Some of the company's cherished practices date back a century



for the second year in a row.) He's backing out of the NBC Universal media business, waiting for his big bets on carbon capture and nuclear technology to pay off, and contending with harsh realities: an appliances unit he couldn't sell, a commercial property unit that could be a drag on earnings for years to come.

When a CEO of Immelt's stature puts his company under the microscope, his own management style inevitably comes in for scrutiny as well. Both current and former GE managers say that for years too much of Immelt's warmth, wit, and attention has been beamed outside the GE family. He is the traveling salesman, the thought leader, the motivational speaker. Inside the company he has been less visible and less available. Despite these shortcomings, Immelt's new effort seems more aimed at his team than at himself. It's about, in his words, making sure they're "really on the right path in a world that I view as being very different in the future than it has been in the past."

Few at GE believe the rethink has anything to do with succession. Immelt was brought into the C-suite with the thought he would stay 20 years, like his legendary predecessor, Jack Welch. The board has remained steadfastly supportive. Welch, who could not be reached for comment, offered sharp criticism when GE had a big earnings miss in April 2008. He told CNBC that Immelt had a "credibility issue" for making promises he couldn't keep. A number of well-regarded lieutenants, including former Vice-Chairman Dave Calhoun and GE Money chief David Nissen, have left the company or retired early on his watch. And executive recruiter Peter Crist says companies that once poached GE talent now look beyond it to alternatives such as Danaher, United Technologies, and even Tyco, which are viewed as "decentralized, sophisticated, and young."

As far as Immelt is concerned, though, the main issue is GE's approach to human capital. Does the company need to retool HR innovations that are now half a century old? Immelt doesn't think so, arguing that GE's processes are both timeless and adaptable. Within GE, the talk is about the new traits leaders will need to thrive, a subject that's reviewed every five years. "We are working on '21st century' attributes," explains Chief Learning Officer Susan Peters. What the insiders don't express doubts about—though a growing number of outsiders do—is GE's talent machine itself. "All of the old success models are coming into question," says Graham Barkus, who heads organizational development at Cathay Pacific Airways. In an age of flattened hierarchies, do time-consuming programs and a largely top-down assessment make sense? GE's Web site boasts: "Our 191 most-senior executives have spent at least 12 months in training and professional development programs during their first 15 years with GE." One entire year—and that's the minimum. GE thinks this is a virtue. What if it's not?

BATTALIONS OF CEOs

In the mid 1950s—the dawn of the age of management science, when the company Thomas Edison founded in 1890 was the fourth-largest corporation in America—company President Ralph J. Cordiner decided to decentralize GE. He made about 120 department general managers responsible for business segments, creating an army of mini-CEOs. That generated the need for more rigorous training and evaluation. So in 1956, Cordiner created the "Session C" assessment and carved a sprawling campus from the leafy Hudson River Valley in Ossining, N.Y., an hour north of New York City, for a management institute. GE Crotonville, as it was known, became synonymous with excellence.

In 1981, Welch, a blunt Boston-born engineer, launched his own revolution. Jettisoning businesses and ripping up bureaucracy, he used Crotonville to drive change across a broad swath of the company. Welch became a fixture at the facility, preaching boundaryless behavior and obsessive efficiency (through embracing the canonical business management strategy known as Six Sigma) and drilling his managers on the fine points of their businesses.

Today, Crotonville still looms large inside GE. But its image in the wider world comes as much from the way Tina Fey and Alec Baldwin parody the place on *30 Rock*. The world has changed, and GE hasn't, at least not very much. "They have a 20th century model for a 21st century world," says John Sullivan, a former chief talent officer for Agilent Technologies who's now a professor of management at San Francisco State University. Sullivan has presented at Crotonville and found

LEADERSHIP PROGRAMS

From the 100-year-old Corporate Audit Staff for finance types to a new Corporate Leadership Staff that aims to get people ready to run a big business by age 30, multiyear training programs annually rotate almost 3,000 enrollees to keep the pipeline full.

SESSION C

Launched in the 1950s, the intense appraisal process rolls through the company over a period of months. Immelt personally reviews the top 625 over 10 days. Until 2008, only the top and bottom tier knew where they stood. Now everyone does.

CROTONVILLE

Being tapped to spend weeks in training at the leafy corporate campus is a sure sign you're viewed as a potential leader. While there's more team-based training and cultural trips these days, the effort to gather people in a central spot remains strong.

BOCA RATON

The annual leadership meeting of GE's top 625 officers. The mission: Share your best ideas, network, and understand the company's strategy for the next 12 months.

THE NEXT BIG THING

From Six Sigma and Work-Out under Welch to Innovation and Growth Traits under Immelt, the company tries to focus GE staffers on central themes or initiatives that get reviewed about every five years.

THE BOSS'S TOUCH

Immelt is holding monthly leadership dinners and biweekly one-on-one sessions to drive new ideas and strengthen his connections with his top team.

that people there seemed stifled by slow reaction times and an internal focus. Bucking the conventional wisdom, Sullivan says that in a flatter, networked world, companies ranging from Hewlett-Packard and Cisco to Best Buy and Deloitte have become better innovators of talent than GE. Scott Belsky, a leadership strategist who founded Behance, which designs products and services for creative industries, concludes that "when it comes to being lean, mean, and productive, GE's processes are great. When it comes to being agile and innovative, these processes can become obstacles."

In interviews with more than 50 headhunters and consultants, questions about GE's centralized approach kept coming up. Some of the experts wanted to be quoted. Some did not, in part because they do business with GE. Many said they admire the company's efforts to get it right. "I think the topic of collaboration struck a chord," says Pino Audia, founder of the Center for Leadership at Dartmouth's Tuck School of Business, who spoke at one of Immelt's dinners. He was struck by how much the attendees "knew each other and knew about leadership. ... GE wants to be the leader here."

While by GE standards Immelt may be morphing into a change agent, he's not talking about blowing up cherished traditions. Crotonville remains the company Mecca. "There is no substitute," says Chief Learning Officer Peters, noting that a trip remains a sign that an executive is being groomed. For Immelt it's only a 45-minute drive from the office. ("I'm at Crotonville every week," he says.) Many of the other 9,000-plus participants in its leadership programs each year fly across the planet to get there. "GE is old-style but good," says Kentaro Iijima, a senior vice-president at Fujitsu Business Systems who was a guest at Crotonville several years ago. But the time commitment is difficult, he says, and "other styles of training have emerged." Iijima uses a team-oriented Web-based program called CoachingOurselves.

At GE, more time-intensive means more valuable. Consider Session C, GE's months-long performance review process. The cycle starts around the beginning of each year and ends with full-day visits to every business in April; Immelt is present at each one. There's a wrap-up in May, a review with board committees in June, a teleconference in August, and another meeting in November—at which point the exercise essentially starts again. One former HR executive at the company, who requested anonymity because he values his friendships at GE, recalls the process with dread. "It felt like your entire team was spending all of December and all of January on this, instead of focusing on the business and on customers," he says. "It was such a time suck." And despite all that energy, despite the famed ranking of GE's top and bottom 10% of performers, it was 2008 before the people in the middle started to learn where they stood relative to their peers. "We were in a 'don't ask, don't tell' environment," says Peters.

FORESTALLING INSULARITY

Immelt says the calamities of the past 18 months prompted him to pause. He wants to experiment with new approaches, accelerate the evolution of GE's processes, and make sure his team has the right tools to "look around corners." Current and former executives notice the effort he has made to forge stronger connections, and they say it's welcome. Whatever the rank-and-file thought of Welch, they never doubted his passion for his people. He knew their names, argued with them as equals, and could reach down several layers to find out what was going on. Immelt looks at the world through a different lens. He likes to test a range of ideas instead of settling on a few and spends much of his time reaching outside GE. Through his monthly dinners and biweekly sessions, though, he now feels he's "able to hit the top 175 people every year in virtually every setting." He has learned something about them. "One of the interesting things in having done this is that you discover—and I'm not sure if this is a good thing or a bad thing—that there really is a GE type. People have different backgrounds, but there is a type of person who tends to do best in the company." The hallmarks, in his words: overachiever, working-class roots, resilience, the ability to be challenged and to learn, a tendency to be self-reflective, and a desire to grow. All good stuff, he says, "but there's always this impediment of 'Why do we have to change if we're good?'"



Thus his openness to reversing the rule that GE employees can't serve on boards. "I want to make sure our leaders have every opportunity to get different inputs so we don't become too insular. It's a danger with every old, big company." Thus, too, an experiment with decentralizing operations in India so that employees there report to a country chief instead of to headquarters. "It's a place where I thought we underachieved. China, we get. We're big. China's big. We know who to talk to. I don't have problems there. India requires more nuance. From a market standpoint, we're not where we should be."

Immelt has always been "a believer that management ideas have almost no shelf life," he says. "By the time an idea gets thought of and in a book and broadly disseminated, it's already two years into a five-year life or a three-year life." Yes, he wants change. But he has come to appreciate all that is good about GE—the attention to nurturing excellence, the constant evolution as a company, the pride it takes and the investments it makes in producing leaders. He points to the processes that have saved the company, not the ones that may have impeded it. "This was the sixth-biggest financial services company in the world the day that Lehman Brothers went bankrupt.



"WE ARE WORKING ON 21ST CENTURY ATTRIBUTES," SAYS CHIEF LEARNING OFFICER PETERS. THE COMPANY REVIEWS ITS KEY LEADERSHIP TRAITS EVERY FIVE YEARS

DAVID YELLEN

Guess what, guys? We're still standing. We didn't take TARP. Everybody has written about commercial real estate and stuff like that. We've taken our shots, many of them deserved. Who did GE Capital compete with? It wasn't JPMorgan and Goldman Sachs. It was CIT, AIG, GMAC."

Immelt knows that stereotypes die hard. He doesn't talk about cutting the bottom 10% or many of the other aphorisms that became famous under Welch. "Some of the conversation about GE is just street lore. It's just things that were written that aren't really true," he says. "It really speaks to what a backwards art management education is. I still hear 'Be No. 1 or No. 2 in your market.' Not even Jack was doing that past 1990. It's like 20 years old. C'mon. The statute of limitations is up."

EXPERTISE: GO DEEP OR GENERAL?

Immelt and his team aren't the only ones raising questions about how to build a better leader for the post-crisis world. Some of the other people on the hunt, however, question whether it is desirable to take top people out of their day jobs for weeks to teach them new skills. Should companies build deep expertise, as GE now prefers to do, or shape more general managers? Does it make sense to talk about a standard set of leadership traits? If GE begins to replicate its India experiment elsewhere or evolve into a collection of autonomous businesses, what's the value of being GE? "People need to see the value proposition of putting all this together," says leadership consultant Gary E. Hayes. "They need to understand what it means for their own careers and futures. What's the magic sauce?"

Consider the experience of one revered brand that hasn't had time to develop leadership programs: Google. For the past decade or so its philosophy has been what Director of Talent Management Judy Gilbert describes as "let's hire fantastic people, bring them in, and set them free." That works best when you're small and have the wind at your back. While there's a growing emphasis at Google on measuring and supporting talent, the company emphasizes peer feedback, two- or three-day leadership programs, and self-directed career planning. "We thought about Crotonville, but we didn't want the formalness of it, the separateness," says Gilbert. As for GE's reputation for ousting the lowest 10% of performers: "When you're killing yourself to hire the right people, it doesn't make sense to cull." And Session C? Gilbert has never heard of it.

Her boss has. Laszlo Bock, Google's vice-president for

GE POWER & WATER CEO BOLZE SHARED LASAGNA AND GOOD TALK WITH IMMELT DURING ONE OF THE CEO'S NEW SLEEPOVERS



DAVID YELLEN

people operations, was hired in 2006 from GE, where he was a vice-president for human resources at GE Capital Solutions. Google, he thinks, is more flexible about managing talent. "To have a monolithic view of leadership sets you up for a lot of problems," he says. Google's approach precludes setting up what he calls a "big, corporate, top-down, university model of training" because it's "too static." It also precludes identifying too many common traits. When his team at Google tried to put some together, they quickly amassed more than 40. "Having the right balance of generalists and specialists is important," Bock argues. "Some leaders excel technically, and some stand out because they're innovative, creative thinkers. What you need is a portfolio of people with widely varying skill sets."

John Lynch, GE's senior vice-president for corporate human resources, agrees. "Is there anything general anymore?" he asks. He believes the beauty of GE's system is that it can be adapted to a rapidly shifting environment. GE measures people on five "growth traits"—external focus, clear thinking, imagination, inclusiveness, and expertise—that are broad enough to allow for wide interpretation. The current push is meant to enhance those traits with more contemporary thinking. "Everything we do drives change," Peters says. "The focus is relentless, and it's a constant evolution." Under Welch, for example, the prized skills were cost-cutting, efficiency, and dealmaking. Then Immelt came in, calling for risk-taking, customer focus, and innovation. Now, Immelt says he's leaning toward "more networking, more managing in volatility ... more orientation toward not just the person, but how the person works within a team." Some readers might think, well, that could mean anything. Maybe it means a blossoming of employee blogs and Twitter accounts. Maybe it takes Immelt in the direction of HCL Technologies, a global IT company, where CEO Vineet Nayar encourages every employee to evaluate the performance of any manager who influences his or her work—including Nayar's—with all the results posted online. "Opening wide the window of transparency not only builds knowledge, it creates trust," says Nayar. "Suddenly, there are far fewer rumors flying around." He views fresh voices as critical because "corporate deterioration happens very slowly" and few in the upper ranks notice it until things are off track. His philosophy: Put employees ahead of customers and "destroy" the office of the CEO by reversing accountability and shifting responsibility for change to the employees.

If that sounds radical, consider IBM. Like GE, it is old—dating back a century—and big. But it's nimble and transparent as well. While GE posts vignettes of selected employees on its Web site, IBM offers a full 400,000-employee directory. It has been an innovator in connecting its people via an internal social network where workers post photos, CVs, and a list of professional skills. That's used by management to fill leadership roles and is part of a system that serves as a "career GPS" for every employee. About 60,000 of the staff are seen as people with high potential to take on leadership roles, according to Ted Hoff, a vice-president who leads IBM's Center for Learning and Development. Because the business is globally decentralized, those leaders can work in hundreds of roles, industries, and specialties without having to move. Where someone is based often matters less in forming teams than their skills. But IBM also sends thousands of people on short-term global assignments every year. While it offers classroom training, the company increasingly favors social networks, Hoff says, and "any other tools that enable peer-to-peer learning." The result of such virtual learning, argues Josh Bersin of research and talent advisory firm Bersin & Associates, is that "companies like IBM and Cisco have become outstandingly nimble globally."

Who is the pioneer of peer-to-peer learning, or what executive coach and author Daisy Wademan Dowling calls the "leaders teaching leaders" model? A company called GE. The main difference at GE is that much of the peer-to-peer learning takes place in front of an audience at Crotonville, now known as the John F. Welch Leadership Development Center. Dowling is a fan of the 53-acre campus, noting that "it makes a gigantic company tiny." The problem is time. "I have difficulty imagining being offline for three weeks," she says.

So far, Immelt's period of reflection has only reinforced his conviction that GE has the tools it needs. He sees Crotonville, Session C, and all the old HR structures as "the melting pot. It's what goes on inside those processes that needs to be updated." |BW|



WE MERELY HAD TO IMPROVE A FOOD THE WHOLE COUNTRY GREW UP LOVING. NO PRESSURE.







Next to the revered hamburger, nothing is more classic to fast food than the french fry. So when a major restaurant chain wanted to create french fries with zero grams trans fat per serving, they knew they couldn't change the taste consumers loved. They called on Cargill, who worked with them to develop a special frying oil. Extensive canola seed research, new processing technologies and an identity preserved supply chain resulted in a cooking oil that performed well for fries, chicken and fish. Consumer tests proved our approach was successful in providing the same great taste. Now our customer serves fries consumers can feel good about, while still enjoying that classic flavor. This is how Cargill works with customers.

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TIVE COMPANIES

By Michael Arndt and Bruce Einhorn

In the past decade, as the U.S. was losing an estimated 2.4 million factory jobs to China, the Economic Policy Institute and other research organizations identified an alarming trend—alarming to Westerners, at least. The factories of South Korea, Taiwan, and China were making their way up the global value chain, from the sneakers, toys, and T-shirts they had produced in earlier years to personal computers, consumer electronics gear, household appliances, and even cars. For the West, the silver lining was this: Asia's high-tech products were still generally regarded as inferior knockoffs of items designed in the U.S. and other so-called knowledge economies. China may have been the biggest worry, but as author Ted C. Fishman argued in his 2005 book, *China Inc.*, it possessed a factory culture—it could imitate but not innovate. ¶ If Asia ever did figure out how to design cutting-edge products comparable to those dreamed up in the West, however, the one-two punch of high-value research and development and low-cost manufacturing would make it almost

unbeatable in the battle for global economic supremacy. ¶ The battle is on. In the 2010 *Bloomberg BusinessWeek* annual rankings of Most Innovative Companies, 15 of the Top 50 are Asian—up from just five in 2006. In fact, for the first time since the rankings began in 2005, the majority of corporations in the Top 25 are based outside the U.S. Asia's newfound confidence is turning up everywhere you look, from wind turbines to high-speed bullet trains, just two of the technologies China is trying to export to the U.S. "We are the most advanced in many fields," Zheng Jian, director of high-speed rail at China's railway ministry, told *The New York Times* in April. "And we are willing to share with the U.S." ¶ The U.S., of course, still has its innovators. Apple remains No. 1, followed by perennial first runner-up Google. But just ahead of General Electric in seventh and eighth places are newcomers LG Electronics of South Korea and BYD, with Korea's Hyundai Motor claiming a spot at 22. ¶ The extended Top 50 list is dominated by companies from Europe, Asia, and, in another first, South America (Petrobrás of Brazil at No. 41). China's rise is biggest. A year ago its only representative was PC-maker Lenovo Group, at 46. This year Greater China is tied with Asia's postwar powerhouse, Japan, thanks to showings by BYD, Haier Electronics (27), Lenovo (29), China Mobile (44), and Taiwan-based HTC (47). The age of Asian innovation has begun. ¶ To make room for these newcomers to the Top 25, which also include Intel and Ford Motor from the U.S. and Virgin Group from Britain, past winners Honda Motor, Reliance Industries, McDonald's, Walt Disney, and Vodafone all got pushed to lower slots on the Top 50, while AT&T dropped off entirely.

"We're starting to see the beginning of a new world order," says James P. Andrew, a senior partner at Boston Consulting Group and head of its global innovation practice. "The developed world's hammerlock on innovation leadership is starting to break a little bit."

HTC is typical of Asia's ascendancy. Founded in 1997 as a contract manufacturer, the company has long been the world's top maker of mobile handsets using Microsoft's Windows Mobile operating system. It produced unbranded devices that bear the logos of such wireless giants as Verizon, T-Mobile, Sprint Nextel, and Japan's NTT DoCoMo.

As it became more sophisticated, HTC built the first phone powered by Google's Android operating system, for T-Mobile, in 2008. It followed up with the Nexus One for Google, which was launched in January. Today, HTC is making and selling its own line of smartphones around the world, and roughly a quarter of the company's 8,000-person workforce hold engineering-related jobs. HTC Chief Executive Peter Chou "looks at what's possible and then puts [in] the resources," says Paul E. Jacobs, CEO of Qualcomm, a mobile-phone chipmaker and HTC partner. "He's willing to take the risk." Says Chou: "Innovation is not a one-time job—innovation is a journey."

These new innovators can provide substantial payoffs for investors. In 2008 a subsidiary of Warren Buffett's Berkshire Hathaway paid $230 million for a 10% interest in BYD, one of China's biggest producers of batteries for cell phones and a fast-growing maker of green cars and solar panels. BYD's Hong Kong-listed stock more than quintupled in 2009, as its profit tripled to $555.5 million. Buffett's stake was worth $2 billion at the end of last year.

Though BYD makes conventional gas-powered cars, with prices starting at just $8,800, the 15-year-old company is branching out to alternative-powered vehicles. BYD, which stands for Build Your Dreams, began selling a $24,900 hybrid car in China this month—the car can be recharged by plugging it into a standard home outlet. It also teamed up with Germany's Daimler in March to build all-electric cars for China. BYD will begin selling electric cars in the U.S. this year and both hybrids and electrics in Europe by 2011.

With millions of Chinese choking on some of the world's most polluted air, the Chinese government is eager to promote more eco-friendly cars, providing an opening for BYD, says Michael Clendenin, managing director of RedTech Advisors, a consulting firm in Shanghai. "If BYD can truly punch something out, they've got a wide-open market in China," Clendenin says. "The Chinese government will come behind them and help them with the charging infrastructure

FIFTEEN OF THE TOP 50 ARE ASIAN—AND FOR THE FIRST TIME SINCE THE RANKINGS BEGAN IN 2005, THE MAJORITY IN THE TOP 25 ARE BASED OUTSIDE THE U.S.

No. 7

CREATIVE WHEN NO ONE'S LOOKING

LG is re-engineering its supply chain so its innovative products will cost less

By Moon Ihlwan

Last year, LG Electronics spent $1.2 billion to market its latest batch of flashy devices, including the LG Cookie, a $200 touchscreen phone that helped cement LG's status as the world's third-largest handset maker. But if you want to see the next big thing at LG, skip the phone store and go to the loading dock. LG, which leapt to No. 7 on this year's Most Innovative Companies list, is building a better supply chain.

Until recently, LG management let each division cut its own deals with suppliers such as TSMC, a Taiwan-based chipmaker. That meant a procurement manager at the handset unit in Seoul didn't know how much his counterpart at a flat-screen TV factory in Mexico paid for chips from the same foundry.

Today no one at LG can issue a purchase order without clearance from the office of "procurement engineering." By centralizing purchases, LG has cut more than $2 billion from its annual $30 billion shopping bill. "Innovation could bring sustainable savings," says Thomas Linton, a 20-year IBM veteran purchasing manager who became LG's first-ever chief procurement officer in 2008.

The change in procurement is part of a grander push by Chief Executive Nam Yong to shake up a siloed company where managers seldom shared their ideas. Since taking over in January 2007, Nam has hired six foreign executives, including Linton, for C-suite roles.

When Linton arrived, LG had a mishmash of processes developed over the years for 115 factories and subsidiaries around the world. He merged them into a single 50-page procurement manual. He has also been working more closely with suppliers such as TSMC. In early 2009 the company forecast strong demand from China for wafers, the silicon disks used to make chips. Linton quickly locked in supplies, saving $1 billion, according to the company.

Linton's team has found other savings. By buying



Flat-panel displays on an LG TV assembly line

aluminum instead of higher-priced copper for the guts of electrical goods such as home appliances, purchasing officers saved $25 million in 2009. "LG's cost competitiveness is pretty strong, particularly in its appliance business," says John Park, an analyst at Daishin Securities in Seoul. "That will help the company's margins for premium products."

The cost-cutting helped LG get through the global downturn better than many competitors. The company posted record revenues and operating profits in the fourth quarter of 2009. In April the Institute for Supply Management named LG the winner of this year's award for leadership and innovation in procurement.

Consumers might not care about such things . But they did notice the LG Cookie's price tag, which was 30% lower than comparable devices when the first model rolled out in late 2008. The company, which has now sold more than 12 million Cookies, couldn't have priced them that low without the innovation at its shipping bays.
–With Kevin Cho in Seoul

to make electric cars in China viable."

The Chinese government is also trying to encourage more companies to be innovators. Beijing has implemented new procurement policies to promote what it calls "indigenous innovation" by requiring locally made technology in certain government purchases. U.S. and other foreign companies have cried foul, alleging that China's new rules favoring locals amount to trade barriers in sectors from environmental technology to telecom (BW—Apr. 5).

"WE'RE STARTING TO SEE THE BEGINNING OF A NEW WORLD ORDER. THE DEVELOPED WORLD'S HAMMERLOCK ON INNOVATION LEADERSHIP IS STARTING TO BREAK."

China's indigenous initiative isn't the main driver of innovation there, according to Boston Consulting's annual survey of top executives, which provides the raw data for our list. The survey suggests the crucial factor is a mindset—a belief that innovation matters. In China, 95% of executives said innovation was the key to economic growth, while 90% and 89% of respondents in South America and India, respectively, agreed. In the U.S., only 72% said innovation was important.

Similarly, 88% of executives in China said they were raising their innovation budgets this year, followed by 82% in South America and 73% in India. The rate fell to 48% in the U.S., ahead of only Japan, where just 34% of executives said their companies planned to increase innovation spending. All of which suggests the U.S. may not be dominating the list again soon.

Even in the U.S., barely half of respondents (53%) said they think U.S. companies will be the most innovative over the next five years. "We're moving to a place where innovation leadership is going to be more dispersed than in just the U.S., Western Europe, and Japan," says Boston Consulting's Andrew.

The shift is more apparent when this year's class is compared with the first ranking in 2005. Back then, only six of the Top 20 were headquartered outside the U.S., vs. 13 of 25 this year. In addition a third of 2005's American champs—such names as 3M, Starbucks, and eBay—no longer make the Top 50.

As specific Asian companies charge ahead in the global ranking, many analysts and executives complain that overall, businesses in China, Korea, and India aren't all that innovative. Their domestic economies are growing so quickly—and there are so many opportunities to launch tried-and-true business models—that these companies don't need to come up with the Next Big Thing. Sticking with the Same Old Thing suits many companies and investors just fine.

"You need something revolutionary to come along in the U.S. to really make an outsize return," says William Bao Bean, a Shanghai-based partner with Softbank China & India Holdings, a $105 million venture fund backed by Cisco Systems and Softbank. In Asia's big two countries, "you don't need to make a revolution," he says. "There's low-hanging fruit to be had."

The huge home market is helping China Mobile grow bigger

THE 2010 INNOVATORS

2010/2009 RANK	COMPANY NAME	STOCK RETURN*	REVENUE GROWTH**	MARGIN GROWTH***	WHY
1/1	APPLE	35%	30%	29%	With remarkable consistency since its founding in 1976, Apple has invented products that have revolutionized demand for digital technology. Look for its latest, the iPad, to disrupt the market for many other portables, including the netbook and even the laptop.
2/2	GOOGLE	10%	31%	2%	Google and Apple once were allies. But with its Droid smartphone, Google has made a run into Apple iPhone territory. Its "Fiber for Communities" project envisions building networks in U.S. cities that will deliver speeds 100 times faster than existing services.
3/4	MICROSOFT	3%	10%	-4%	The software leviathan is still nimble. Its Windows 7 operating system fixed shortcomings of Vista, while Bing has more than 10% of the online search market. Next up: Microsoft Outlook 2010, which synchronizes e-mail, contacts, and social-media applications.
4/6	IBM	12%	2%	11%	The company that gave the world the PC long ago got out of the hardware business, remaking itself into a global technology consultant. For example, it has collaborated with a Toronto hospital to help doctors monitor minute changes in the health of premature babies.
5/3	TOYOTA MOTOR	-20%	-11%	NA	Oops. For years the world's biggest carmaker was a role model for innovation, thanks to its reputation for high-quality vehicles and industry-leading hybrid lineup. Following massive recalls for sudden-acceleration problems, Toyota's next reinvention is its own image.

2010/ 2009 RANK	COMPANY NAME	STOCK RETURN*	REVENUE GROWTH**	MARGIN GROWTH***	WHY
6 / 11	AMAZON.COM	51%	29%	6%	The iPad may aim to rout the Kindle, yet Apple's tablet hadn't even hit stores when Amazon announced Kindle apps for iPad and Mac. Books are a shrinking part of an online retail empire. Electronics were almost half of Amazon's 2009 fourth-quarter sales.
7 / 27	LG ELECTRONICS	31%	16%	707%	CEO Yong Nam has hired top talent from multinational leaders such as IBM, Hewlett-Packard, and Procter & Gamble to turn LG into a global entity in consumer electronics. The business world has noticed the change, lifting its ranking from 27th last year.
8 / NR†	BYD	99%	42%	-1%	Publicly traded since late 2007, BYD is the first Chinese company to make the list. BYD sells gas-powered automobiles in China, but it has caught the attention of Warren Buffett and others for its latest products, hybrid cars and plug-in electric vehicles.
9 / 17	GENERAL ELECTRIC	-22%	-1%	-25%	The conglomerate operates a research center working on everything from nanotechnology to bioscience. The labs last year filed 2,537 patent applications. Among the new projects is the Human Connectome, an attempt to produce a wiring map of the brain.
10 / 14	SONY	-19%	-5%	NA	Sales of Sony's PlayStation 3 video game consoles have picked up since the Tokyo-based company brought out a slimmer, cheaper model last September. The company plans to introduce its "Move" motion-sensing controller for the PS3 later this year.
11 / 16	SAMSUNG ELECTRONICS	10%	17%	-9%	The Korean giant has invested billions of dollars in 24 R&D labs worldwide to cement its leadership in memory chips and TVs. It rolled out its first line of 3D sets this spring but faces an uphill fight in smartphones against Apple and Research in Motion's BlackBerry.
12 / 33	INTEL	3%	0%	12%	The world's largest chipmaker has continued its industry-leading spending on research and development. Among the payoffs this year: a new server chip that delivers performance that would have required a combined 15 of its 2005 predecessors to match.
13 / 31	FORD MOTOR	10%	-12%	NA	Ford survived the recession without a government bailout or bankruptcy. Its March sales soared 43% above year-earlier levels on the strength of its fuel-efficient lineup and rivals' woes. Ford's Fusion is the biggest selling domestic hybrid.
14 / 8	RESEARCH IN MOTION	17%	75%	-6%	The BlackBerry's maker has invested much of its recent research budget into speeding up the text-typing capabilities of its smartphones. But touchscreen handsets from Apple and others are threatening to turn the device into an also-ran.
15 / 18	VOLKSWAGEN	8%	0%	14%	The German automaker showed off its green credentials at the Los Angeles auto show in December with its Up! Lite. The 70-mile-per-gallon, aluminum-and-carbon fiber car can cruise at up to 100 mph. Meantime, its Audi unit is gaining in the luxury-car market.
16 / 7	HEWLETT-PACKARD	9%	8%	9%	HP, which preaches "innovation through autonomous thinking," still makes printers, laptops, and inkjet cartridges. But at its Sustainable IT Ecosystem Laboratory, it thinks big. One project: finding ways to build energy-efficient, sustainable cities.
17 / 13	TATA	Private	Private	Private	Known for its ultracheap minicar, the Nano, Tata takes innovation so seriously that it's developed an "Innometer." The conglomerate measures creative goals and accomplishments vs. domestic or global benchmarks while instilling a "sense of urgency" among employees.
18 / 20	BMW	-8%	0%	NA	BMW got to be one of the world's most successful luxury car companies through relentless invention. One recent example: night vision, which uses far-ranging infrared technology to transmit images of potential hazards to an in-dash screen.
19 / 24	COCA-COLA	9%	9%	1%	Coca-Cola brought the flash of race cars and high-tech wizardry to its fountain-drink dispenser redesign. Its Freestyle machine stocks more than 100 different drinks. It uses Microsoft technology and style points from designers of Italian sports cars.
20 / 5	NINTENDO	-8%	22%	3%	Wii sales began falling last year after dominating the market for video game consoles since 2006. The company has since cut prices and sales projections. Nintendo's new plan to revive growth: a 3D version of its DS handheld player that doesn't require glasses.
21 / 10	WAL-MART STORES	7%	6%	-1%	Wal-Mart earned its rep as an innovator by driving down supply-chain costs. More recently the big-box retailer has been innovating to burnish its green credentials, setting a goal to reduce packaging by 5% by 2013. Laudable, sure. Novel, maybe not so much.
22 / NR†	HYUNDAI MOTOR	23%	12%	17%	Not that long ago, Hyundai was just another Korean company that made cheap cars. Today, with a global R&D network that spans the U.S., Europe, Japan, and India, it's developing an "i-flow" concept car that greatly lowers greenhouse gas emissions.
23 / 9	NOKIA	-14%	0%	-37%	The world's largest mobile-phone maker assigns about a third of its workforce to R&D in areas as disparate as nanotechnology and social networking. But after getting caught flatfooted by Apple's iPhone, it has been losing share in the lucrative smartphone market.
24 / 34	VIRGIN GROUP	Private	Private	Private	Founder Richard Branson has used Virgin to launch more than 200 branded companies with interests in airlines, mobile communications, media, and fitness. For $200,000 you can book a seat with Virgin Galactic, the world's first "spaceline."
25 / 12	PROCTER & GAMBLE	1%	5%	2%	Last year was a transitional one for this consumer products company. CEO A.G. Lafley was succeeded by Robert McDonald. The new chief shifted P&G's focus from new upscale products to improving lower-priced goods more suited to recessionary times.

*Stock returns are annualized, Dec. 31, 2006, to Dec. 31, 2009, and account for price appreciation and dividends.
**Revenue and operating margin growth are annualized based on 2006-2009 fiscal years. Margin growth is earnings before interest and taxes as a percentage of revenues. Where possible, quarterly and semiannual data are used to bring performance for pre-June yearends closer to December 2009. Financial figures are calculated in local currency.
***Calculating three-year compound annual growth rates for operating margins is not possible when the starting or end figure is negative.
+Not ranked in 2009's survey.

2010/ 2009 RANK	COMPANY NAME	STOCK RETURN*	REVENUE GROWTH**	MARGIN GROWTH***
26 / 22	HONDA MOTOR	-11%	-9%	NA%
27 / NR†	FAST RETAILING	17%	15%	0%
28 / NR†	HAIER ELECTRONICS	28%	22%	-15%
29 / 19	McDONALD'S	15%	2%	10%
30 / 46	LENOVO	18%	-1%	NA
31 / 32	CISCO SYSTEMS	-4%	8%	-6%
32 / 21	WALT DISNEY	0%	2%	0%
33 / 15	RELIANCE INDUSTRIES	21%	23%	-4%
34 / NR†	SIEMENS	-3%	-4%	27%
35 / NR†	DELL	-17%	-4%	-7%
36 / 38	NESTLÉ	8%	4%	1%
37 / NR†	BRITISH SKY BROADCASTING	6%	9%	-10%
38 / 25	VODAFONE	6%	17%	-13%
39 / 47	JPMORGAN CHASE	-2%	18%	-21%
40 / NR†	ORACLE	13%	13%	5%
41 / NR	PETROBRAS	18%	5%	-11%
42 / 42	BANCO SANTANDER	2%	-1%	8%
43 / 48	FIAT	-10%	-2%	-12%
44 / NR†	CHINA MOBILE	1%	16%	1%
45 / NR†	GOLDMAN SACHS	-5%	6%	4%
46 / 43	NIKE	12%	5%	2%
47 / NR†	HTC	6%	11%	-11%
48 / 40	FACEBOOK	Private	Private	Private
49 / 36	HSBC	-5%	-7%	-45%
50 / 30	VERIZON COMMUNICATIONS	1%	7%	6%

and, the company hopes, more advanced. The world's largest cellular operator agreed last month to buy 20% of Shanghai Pudong Development Bank for $5.8 billion. The investment should help China Mobile provide wireless banking services to its 527 million customers, helping to solve a chronic problem plaguing the e-commerce industry in China, where use of credit cards is not widespread.

For many companies, though, relying on the easy pickings in China and Taiwan is no longer an option. HTC is feeling pressure from Chinese rivals such as ZTE Corp. and Huawei Technologies, which are taking advantage of Google's open-platform Android operating system to get into the smartphone business, too. "Android has become the great equalizer," says Aloysius Choong, an analyst in Singapore with researcher IDC. Because Android takes a lot of the innovation burden off of the hardware companies, it lowers the entry barrier for newcomers. That's one reason analysts think HTC may make an offer for Palm, the U.S.-based smartphone maker that has put itself up for sale, according to people familiar with the situation. The battle is notable, of course, because it is an innovation-driven skirmish between Chinese and Taiwanese players—something that simply didn't happen a decade ago.

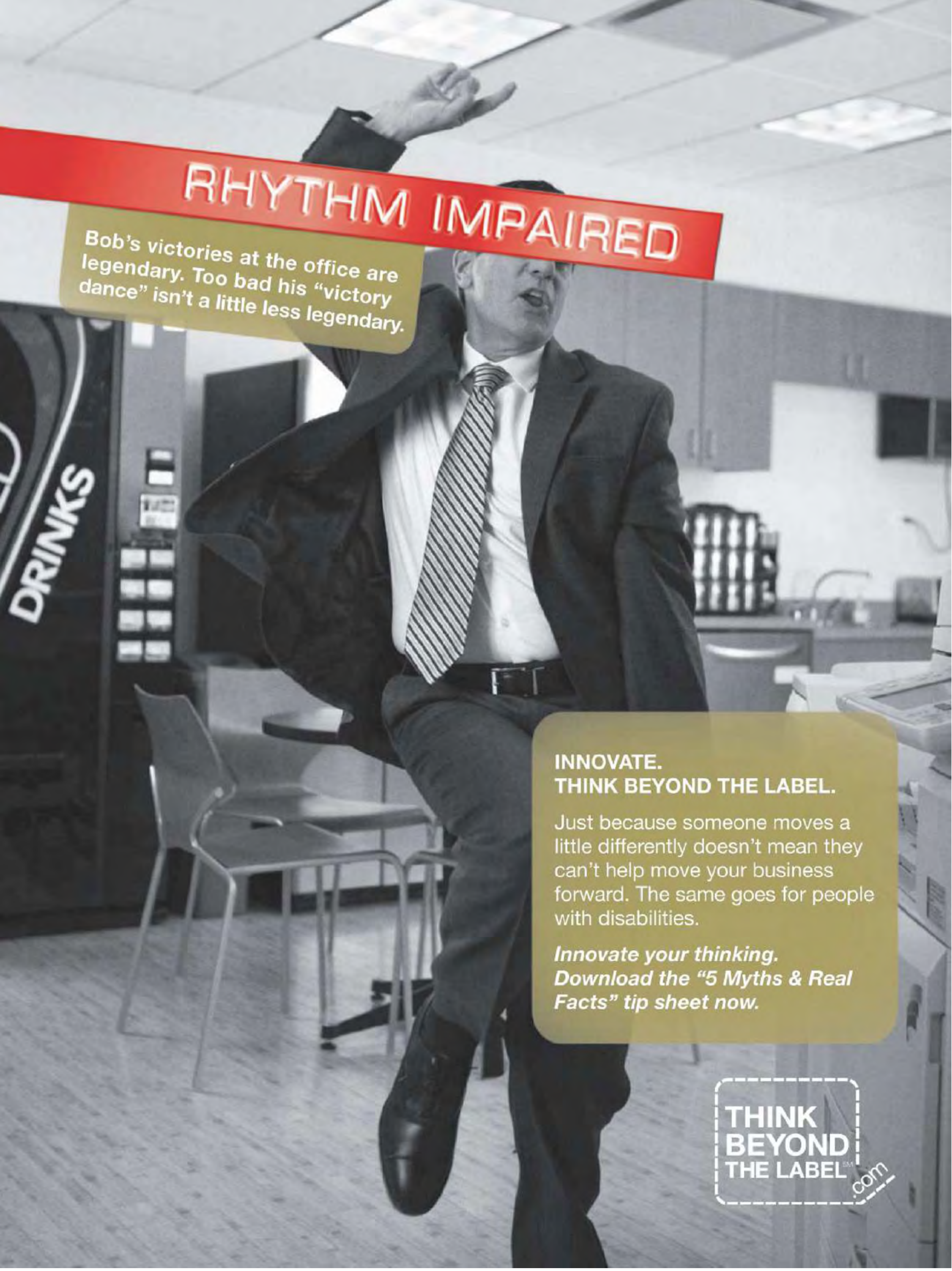
Chou, HTC's chief, acknowledges that competition is intensifying. "We never underestimate the potential competition coming from elsewhere, either from top-tier premium brand companies or companies from China or Taiwan. What is important for HTC, we need to continue to provide a unique and differentiated value to our customer."

Apple also wants to take HTC down a peg. In March, the iPhone-maker filed a complaint with the U.S. Federal Trade Commission and a lawsuit in U.S. District Court alleging HTC's smartphones infringed on Apple patents. HTC denies the claims. "HTC has been innovative from the beginning," says Chou. "We were working on this for a long time before the iPhone came out." |BW|

–With Tim Culpan in Taipei

Bloomberg BusinessWeek*'s Most Innovative Companies special report is based on data from longtime partner Boston Consulting Group (BCG). Last December the consultancy e-mailed a 21-question poll to senior executives around the globe. The 1,590 respondents, who answered anonymously, were asked to name the most innovative companies from outside their own industry in 2009. BCG then factored in the financial performance of the top vote-getters. The final list weights the survey results 80%, stock returns 10%, and three-year revenue and margin growth 5% each.*

For the 2010 report, BCG changed the survey's distribution so that responses better reflected each country's share in the world economy. That meant fewer questionnaires to India, Italy, Spain, and the U.S. and more to Germany, Japan, and other countries in Asia. To improve the response rate, BCG also translated the poll into Japanese and Chinese. BCG found that the recalibrated sample may have altered the rankings of individual companies by a few places, but it did not account for the tilt away from the U.S. and toward the rest of the world. Performance and reputation did.


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No. 47

HTC'S ELEGANT DEAD-END PHONE

By Rich Jaroslovsky

COMMENTARY

There's a lot to like in HTC's new HD2 smartphone. Start with the huge 4.3-inch touchscreen—the largest available, according to T-Mobile, which introduced the device in March. Add the same Qualcomm Snapdragon processor that powers Google's Nexus One, also made by HTC. Include a 5-megapixel camera with flash. And put it all into a sleek package that fits in a shirt pocket. What you get is a very nice phone that has no future. Because the HD2 is powered by a soon-to-be-obsolete version of Microsoft's mobile operating system, it is basically a pretty orphan. It demonstrates how even an innovative company (No. 47 on our list) can be hobbled by suppliers peddling out-of-date technology.



Microsoft was early to recognize the importance of handhelds, but whatever first-mover advantage it had is long gone. Successive versions of its mobile software have been quirky and clunky, saddled with the company's determination to treat the devices as if they were shrunken PCs, complete with an on-screen "Start" button, just like in Windows. While Microsoft struggled to get the software right, BlackBerrys took over the corporate market, and then Apple rewrote the rules for the consumer market with its iPhone.

Version 6.5 of Windows Mobile, released last fall, placed a nicer-looking interface over the same old software—and did nothing to arrest the company's slide. Microsoft's share of U.S. smartphone subscribers fell to 15.7% in the three months ended in January, according to comScore. That was a decline of four percentage points from the preceding quarter; already trailing Research in Motion and Apple, Windows Mobile may fall behind Google's Android platform, too.

While Microsoft just unveiled two phones aimed at younger, social networking users, its next-generation operating system, to be called Windows Phone 7, won't show up until late this year. The new software will not be backwards-compatible, meaning HD2 users shouldn't expect to be able to run it or applications written for it. So T-Mobile customers are being asked to plunk down $199 and sign a two-year service agreement for a phone whose freshness date is about to expire.

That's a shame, because the hardware is superb. Start with that screen, which makes movie watching on a plane or train a pleasure. T-Mobile ships the HD2 with the two *Transformers* movies preloaded (which gives you an idea of the demographic it's after) and an app from Blockbuster to find and download more. The screen's size, and the vibrations the virtual keyboard provides for tactile feedback, make it easy for stubby-fingered users like me to type even in portrait mode.

Elegant hardware doesn't compensate for baffling software. HD2 uses Sense, HTC's proprietary, intuitive user interface. But it's way too easy to stumble from the Sense interface into Windows Mobile's. The front of the phone has two buttons side by side. Pressing the one with the "home" icon takes you from wherever you are back to the main Sense desktop screen. Pressing the one next to it with a Windows logo takes you to the main Microsoft desktop screen, which has an entirely different look and feel. I'm used to this sort of Windows phone weirdness, and even I kept pushing the wrong buttons.

Let's recap: a great phone with a doomed operating system that relies on the troubled Blockbuster chain for its movies and the sometimes spotty T-Mobile network for its signal. The HD2 shows that when it comes to handhelds, hardware innovation is less than half the battle. |BW|

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Istanbul. Turkey has prospered while tension between Islamists and secularists has increased

TURKEY'S MOMENT

ITS ECONOMY IS HOT AGAIN AFTER A PAINFUL 2009, AND SOME ECONOMISTS SAY IT'S A GERMANY IN THE MAKING. THE POLITICS, THOUGH, ARE RAUCOUS



KATHRYN COOK/AGENCE VU/AURORA

Turkish Premier Recep Tayyip Erdoğan has had a busy two months. First he publicly defended a controversial investigation into a possible coup attempt by the army. Then the premier clashed with the hostile Turkish judiciary over the high court's right to ban political parties, including his own. On Apr. 9, the country's top prosecutor delivered a blistering speech against Erdoğan, who many Turks fear is out to create an Islamist state.

This kind of political turmoil long made Turkey radioactive as far as the financial markets were concerned. So what are investors, including foreigners, doing now? They're buying Turkish stocks and bonds in record amounts. The Istanbul Stock Exchange index hit an all-time high on Apr. 9, capping a 52-week run that has seen stocks double in value.

Stoking investors' enthusiasm is the conviction that Turkey's economic fundamentals have improved so much in the past eight years that political strife won't

BY STEVE BRYANT & BEN HOLLAND

stop the forward momentum. "This is an economy with a deep manufacturing base and a large middle class," says Murat Köprülü, the Turkish-born chairman of Multilateral Funding International in New York, which manages about $120 million of emerging-market assets. "[Turkey] is going to pick itself up again after a political crisis and show growth."

Erda Gerçek isn't fazed either. He left Turkey 20 years ago and has worked as a fund manager at Citigroup and Legg Mason. Recently he moved back to his homeland to teach fund management at Istanbul Bilgi University and Izmir University of Economics. "In the time I was away, Turkey went from a highly volatile, boom-and-bust economy to one that's relatively stable as inflation and interest rates came down," says Gerçek, 44.

Credit for this transformation goes to Erdoğan and his deputy prime minister, Ali Babacan, who is a graduate of Northwestern's Kellogg School of Management. Erdoğan's Justice & Development Party was elected with a strong majority in 2002. Speculative trading by Turkish banks in government bonds and the Turkish lira had triggered a financial crisis.

TURKEY'S LONG ROAD TO REFORM



Data: Bloomberg, Turkstat, Citigroup

Erdoğan and Babacan used their majority and capitalized on the sense of emergency to ram through numerous reforms. They reined in government spending, sold $30 billion worth of state-owned companies, strengthened financial regulatory agencies, and tightened capital reserve requirements for banks. They actively pressed for admission to the European Union, citing EU membership requirements as another reason for deep change. "It was bitter medicine," recalls Ziya Akkurt, chief executive of Akbank, one of Turkey's largest banks.

The medicine worked. Turkey had a prosperous decade as rates came down and banks started to lend after a period in which there was precious little lending. Foreign capital from Ford, Vodafone, General Electric, and other multinationals poured in to build manufacturing in autos, appliances, and information technology. Trade with Europe and the Mideast boomed; exports have tripled since 2002, to $102 billion.

The real test of Turkey's financial strength came last year, as the global crisis tipped the world into recession. The country's gross domestic product contracted almost 5%, a painful adjustment. But the lira did not crash as it once did in dire circumstances. Instead the currency has held close to 1.50 per dollar since October 2008, even as the central bank has slashed interest rates by more than half, to a record low of 6.5%. The cost of insuring against a default on Turkish debt has plunged in the past 12 months, to 160 basis points from more than 340 a year ago. Six EU member countries, including Turkey's neighbors Greece and Bulgaria, are more likely to default.

Erdoğan, 56, recently cast aside what he calls "walking stick" loans from the International Monetary Fund, which sustained Turkey through most of the past two decades. The premier announced on Mar. 10 that Turkey was breaking off almost two



"IN THE TIME I WAS AWAY, TURKEY WENT FROM A HIGHLY VOLATILE, BOOM-AND-BUST ECONOMY TO ONE THAT'S RELATIVELY STABLE"

Former fund manager Erda Gerçek

CHARTS BY STANFORD KAY; PHOTOGRAPH BY KEREM UZEL/BLOOMBERG



TURKEY SURVIVED THE FINANCIAL CRISIS WITHOUT BANK BAILOUTS AND DOESN'T NEED THE IMF'S HELP

Premier Recep Erdoğan

UMIT BEKTAS/EPA/ZUMA PRESS

years of loan renewal talks with the IMF and turning its back on a credit line worth as much as $40 billion. Turkey survived the global economic crisis on its own without bailing out a single bank, Erdoğan said, and it doesn't need the money.

Turkish businesses are now preparing for a strong year. GDP increased at an annualized rate of 6% in the fourth quarter of 2009, lagging behind only China among the Group of 20 nations. On Apr. 2, Deputy Prime Minister Babacan said the economy may have expanded by more than 10% in 2010's first quarter.

Affordable credit, says billionaire industrialist Ahmet Nazif Zorlu, is helping enterprises expand both at home and abroad. His Zorlu holding company, which already makes 15% of Europe's televisions under contracts, is now developing Turkey's biggest real estate project, a $2.5 billion hotel, shopping, and luxury apartment complex in Istanbul. Zorlu's company is also building what will be Israel's largest privately held power plant. Turkey's biggest bank, Iş Bankasi, is on the acquisition trail, too, especially as beleaguered Greek financial firms prepare to shed assets, particularly in the Balkans. "We keep looking for opportunities, and I think the problems in Greece will trigger some interest by Turkish banks," Chief Executive Officer Ersin Ozince told reporters on Mar. 31.

A nascent high-tech sector is profiting from government attention. Bülent Çelebi returned to Turkey in 2004 after more than a decade working in Silicon Valley. His Istanbul-based company AirTies makes wireless routers and Internet TV technology, and he sees progress. "I used to come to all these conferences and think that nobody ever listens. But maybe they listened," Çelebi says of the Erdoğan government. "They took tangible action. They said, 'OK, every school in Turkey is going to have [broadband].'" Türk Telekom in Ankara has extended broadband networks throughout the country, adds Çelebi, whose company had $36 million of sales last year. The more broadband there is, the more business there is for companies like AirTies.

Can Turkey keep up the pace? In 2005, Jim O'Neill, Goldman Sachs' chief global economist, listed Turkey among the "next 11" countries that could become world economic leaders (that's "next" as in "after Brazil, Russia, India, and China"). Sustaining a 6% average rate of growth could put Turkey's $620 billion economy ahead of Germany's by 2050, Goldman's Ahmet Akarli wrote in a follow-up report published in 2008.

Gerçek, the former fund manager, thinks that 6% average growth is "perfectly achievable." Turkey's demographics "can sustain very high levels of growth," and there's "ample potential" to put more young people to work in industries that are more productive, he says. More than a quarter of Turkey's 72.6 million people are under 15 years of age, while just 6% are over 65. Turkey is younger than China, where 19% are under 15. Young workers in an economy not only produce, they also start families and buy homes, a big boost to consumption.

Turkey's service economy is just starting to develop. "The Turkish market is still unsaturated in many banking products, such as insurance, mutual funds, pension funds," says Akbank's Akkurt. The bank earned $1.8 billion last year, while Citigroup, which owns 20% of the Turkish bank, lost $1.6 billion.

For all its advances under Erdoğan, the Turkish economy still has soft spots. Prices increased 9.6% in March compared with a 5.1% rise last year, prompting some economists to question whether Turkey has solved its long-term tendency to inflation, which was 39% in 2002. "In the most disinflationary environment you can imagine, inflation bottomed. And in the blink of an eye, ping! It was back," says Akarli, the author of Goldman Sachs' 2008 report. This inflationary bent is all the more worrisome given that unemployment remains high at 14%. If the recovery really takes off and more workers are hired and wages rise, Turkey could find itself struggling with bad inflation again.

The other soft spot, despite the market's tendency to shrug it off, is politics. Erdoğan's battles with his adversaries aren't over. Nor is the big question of Turkish politics settled: Whether Turkey should preserve its strictly secular traditions or follow the pious Erdoğan and embrace Islam more closely. As part of that battle, Erdoğan proposed constitutional changes last month that would make it harder to ban political parties. In 2008, the Constitutional Court rejected a lawsuit to close Erdoğan's Justice & Development Party by a single vote. The premier also wants to increase parliament's role in judicial appointments, a move that indirectly would expand his influence greatly. Opposition leaders and top judges have lined up to denounce Erdoğan for trying to politicize the courts.

Erdoğan could become Turkey's longest-serving premier in more than 60 years if he wins reelection in 2011 as expected. Yet the attacks on him will likely continue until then, and at some point investors may grow alarmed. The next Germany? It's certainly possible. But even the skillful Erdoğan could do with a stretch of political peace. |BW|

THE ACCOUNTANT OF COAL

Massey Energy CEO Don Blankenship says "greeniacs" want to destroy America. Critics say his hunger for profits led to safety lapses at the Upper Big Branch mine, where 29 died this month





(L TO R) HARAZ N. GHANBARI/AP PHOTO; MATT SULLIVAN/GETTY IMAGES

BY MARGARET CRONIN FISK, BRIAN K. SULLIVAN, AND KAREN FREIFELD

Mingo County, W. Va., is a famously truculent place. In the rolling hills by the Kentucky border, the Hatfields and McCoys feuded in the late 1800s. In 1920 a gun battle broke out in the Mingo town of Matewan between workers and coal agents over efforts to organize the mines. Ten died in the "Matewan Massacre," one of America's bloodiest labor clashes.

Don Blankenship, who attended high school in Matewan, is a creature of his environs. Sixty years old, burly and combative, Blankenship is the chairman and CEO of Massey Energy, which owns and operates the Upper Big Branch mine in Montcoal, W. Va., where an explosion on Apr. 5 killed 29 miners and injured two more. An accountant by training, Blankenship is an unapologetic capitalist who takes a dim view of regulators, "greeniacs," and "people of the far-left communist persuasion," as he described environmentalists in a November 2008 speech. Some investors and industry veterans say there's a connection between the explosion, the second fatal incident at a Massey mine in four years, and Blankenship's desire for profit. In an Apr. 12 letter to Massey directors, William Patterson, executive director of CtW Investment Group, which advises pension funds, called the deadly blast "the tragic consequence of the board's failure to challenge ... Blankenship's confrontational approach to regulatory compliance." Blankenship and Massey did not return calls for comment; his attorney, Thomas V. Flaherty, told Bloomberg News that at Massey, "safety is Job One."

Over the years, Blankenship has wielded power in a variety of ways. He has traveled into the mines to persuade workers to abandon union organizing efforts. He has inserted himself into local politics, bankrolling a campaign that helped topple a local judge who had ruled in favor of workers. "Don Blanken-

A day after the disaster, Blankenship faced the media in Montcoal, home to the Upper Big Branch mine (below)



ship is perfect for Massey Energy," says Kevin Thompson, a lawyer who in 2004 mounted a still-pending class action against the company for allegedly contaminating groundwater in the county. "It's more than cost-cutting with Blankenship. It's a need to control. It's a need to win."

Since the explosion at the Upper Big Branch mine, Blankenship has been uncharacteristically quiet. Yes, he has twittered constantly (sample: "We regret the national news is so inaccurate") and expressed his condolences to the families of the dead. But Blankenship the provocateur has gone into hiding. With the federal government investigating and regulators vowing to tighten rules, the self-described "street fighter" is facing the toughest challenge of his 28-year career. On Apr. 12, New York State Comptroller Thomas P. DiNapoli, who oversees a retirement fund that owns 303,550 shares of Massey stock worth $14.1 million, called for Blankenship to resign. "We have to protect shareholder value," he told Bloomberg Television. "There need to be changes at Massey."

Donald Leon Blankenship grew up next to the railway tracks in Delorme, a small town in Mingo County. "Don was raised in a very hardscrabble existence by a single mother," says Flaherty. He worked as a union miner and put himself through Marshall University, where he earned an accounting degree. Blankenship began his Massey career as an office manager at the company's Rawl Sales & Processing unit in January 1982 and was named president of Rawl in May 1984. He has been chairman and CEO of Massey Energy since 2000 and head of A.T. Massey Coal, a wholly owned subsidiary, since 1992. "He's a bottom-line, number-crunching accountant who managed to become CEO of a company," says attorney Bruce Stanley, who has battled Massey in court. "He's driven by budgets and numbers."

Stanley and other adversaries contend it was Blankenship's dogged opposition to the United Mine Workers of America that won him the top job at Massey. In 1984, Blankenship persuaded Massey's management to oppose the contract the union had negotiated with other coal companies, according to Phil Smith, a union spokesman. Blankenship demanded a separate contract for each mine, Smith says. The union refused and went on strike. "It was very vicious, the first time in 60 years that a mine operator brought in strikebreakers [and] armed guards," Smith says. The strike lasted four years, Smith recalls.

By 1988, Massey had sold or closed 18 of 23 unionized facilities, says Smith. Today the Mine Workers represents only two of its coal-processing plants, he says, and no mines. The union tried three times to organize workers at Upper Big Branch. The first vote was a tie. The union lost the second by 14 votes and withdrew its petition before a third vote was taken, he says. "When we began, we had over 70% of the people who signed [union] cards," Smith says. "Then Don Blankenship went into the mines and talked to the miners. He was his own personal union-buster."

In January 2006 a fire broke out in Massey's Alma No. 1 mine, 60 miles from Charleston, W. Va. Two miners died and nine were hurt. The widows sued Blankenship, Massey, and Aracoma, the affiliate that runs the mine. Citing a memo Blankenship sent his mine superintendents in October 2005, the widows alleged he was personally responsible for safety problems. In the memo, he urged superintendents to ignore orders to do anything other than "run coal." This included working on construction projects involving "overcasts," ventilation controls that help keep the mines safe. "This memo is necessary only because we seem not to understand that coal pays the bills," Blankenship wrote.

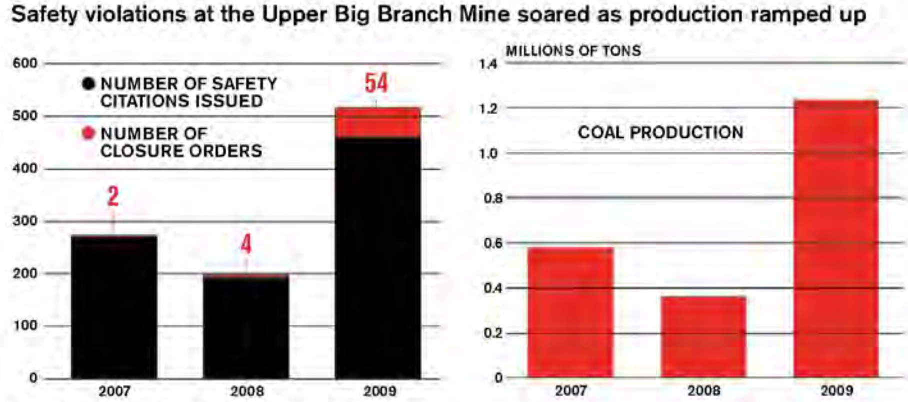
The widows claimed in the suit that the memo demonstrated that it was company policy to downgrade safety in favor of production. Blankenship denied responsibility and claimed the widows' lawyers quoted the memo out of context and failed to include a subsequent communication reminding the managers that safety "is our first responsibility," according to court



In Massey Energy's coal country (left), says an ex-miner, "you are either going to work in the mines or flip hamburgers"; a vigil for the dead

ANATOMY OF A DISASTER

Safety violations at the Upper Big Branch Mine soared as production ramped up



Data: Mine Safety & Health Administration

(L TO R) PHOTOGRAPHS BY CRAIG CUNNINGHAM/CHARLESTON DAILY MAIL/AP PHOTO; AMY SANCETTA/AP PHOTO; CHARTS BY STANFORD KAY





papers filed in 2008. "Anyone who gives a fair reading of that memo would agree that it's torturing the facts," says Flaherty, who defended Blankenship in the suit.

Blankenship said in a deposition that he shut down mines if he saw safety problems. "In the 20 years since I have been empowered at Massey, we have beat the industry average [for accidents] 18 times, tied it once, and we have been beat by the industry average one time," he said. The widows settled during trial, on confidential terms. The fire, along with a second fatal explosion at another mine that year, prompted federal regulators to enact tougher mine safety laws.

Blankenship has made no secret of his aversion to what he deems judicial meddling in business. In 2004 he backed Brent D. Benjamin in an election against Warren McGraw, a justice on West Virginia's Supreme Court of Appeals who was known for ruling against employers and in favor of workers. Blankenship told a local newspaper, "Warren McGraw says he's for the working man, but he's not." He gave $2.5 million to a political action committee called "And for the Sake of the Kids." The group aired TV commercials criticizing McGraw's decision, as part of a three-judge panel, to release a convicted pedophile. Benjamin won a 12-year term on the court. In the summer of 2006, according to court papers, Blankenship met in Monte Carlo with another judge, Elliott "Spike" Maynard.

A little more than a year later, Benjamin and Maynard joined a 3-2 decision overturning a ruling that would have forced Massey to pay $50 million in damages to rival Harman Mining for forcing it out of business. Both justices denied any bias, pointing to decisions where they disagreed with Massey. Maynard then recused himself, but at the rehearing Massey won another 3-2 vote, with Benjamin's support. Benjamin and Maynard didn't immediately return calls for comment.

Last June the U.S. Supreme Court ruled that Benjamin should have recused himself and ordered the state Supreme Court of Appeals to rehear the case. By November, when the case was reheard, Maynard had been defeated, and Benjamin had recused himself. Once again the court threw out the jury verdict. "It is a shame that there has been yet another miscarriage of justice in this lengthy saga," Stanley said at the time.

Blankenship, his opponents and supporters agree, simply has to get his way. Nothing illustrates this better than his fight with a maid earning $8.86 an hour. In 2001, Deborah May started working for Mate Creek Security, a company "related to Massey Energy," according to court documents. When Mate Creek assigned her to work for Blankenship, according to the documents, May cleaned his three-story home, shopped, and did laundry. By 2005 she was also cleaning a bus, two cabins, and a mansion in Kentucky. She received one 30¢ hourly raise. After Blankenship said she would also have to care for a "German police dog," according to the documents, she quit.

In November 2005, May applied for unemployment benefits, saying she was forced to leave the job. The state denied her claim, concluding she quit for no reason. In June 2008, West Virginia's top court reversed the state's denial of benefits. Two of the court's justices said "the unrefuted evidence" showed that Blankenship "physically grabbed" the maid, threw food after she brought back the wrong fast-food order, and tore a tie rack and coat hanger out of a closet after she forgot to leave the hanger out for his coat. "This shocking conduct" showed May was in effect fired because she felt compelled to quit, the justices said. They said the conduct was "reminiscent of slavery and is an affront to common decency."

Blankenship has a complicated relationship with the people of West Virginia. In a state where the jobless rate hovers at 9.5%, mining jobs have been paying the rent for generations. "You are either going to work in the mines or flip hamburgers," says Chuck Nelson, who was a miner for 26 years before quitting in 2000. Last May, when the Tug Fork River flooded Matewan, Blankenship was one of the first people to greet Mayor Sheila Kessler. "He told us we could have whatever we needed, manpower, equipment, he even called back laid-off miners," Kessler says. Blankenship's company hands out gifts to children at Christmas and donates $100,000 a year to the city's museum.

The explosion that ripped through the Upper Big Branch mine at 3 p.m. on Apr. 5 has hardened some hearts in coal country. The cause of the explosion remains under investigation, but high levels of methane gas hampered recovery efforts and may have contributed to the blast. The Mine Safety & Health Administration has issued more than $900,000 in fines at the mine in the past 16 months. In January, inspectors found problems with ventilation systems designed to prevent the buildup of methane. The Upper Big Branch was cited for 38 "mine ventilation" violations in the past 12 months, according to federal records. Coal production at the mine increased threefold last year, while the number of violations doubled (chart).

When Blankenship visited the mine shortly after the incident, he was escorted by more than a dozen police officers. Nelson, the retired miner, recalls a Labor Day rally funded by Blankenship, who wore a shirt emblazoned with the American flag and thundered about regulators and politicians who "have no idea how to improve miner safety. The very idea that they care more about coal miner safety than we do is as silly as global warming." "All he did was criticize the government, and the whole time he's dressed in the Stars and Stripes," Nelson says. "He's anti-American." |BW|

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FINANCE

Let's Have a Beer and Talk Derivatives

In the fiery debate over financial reform, MillerCoors and Anheuser-Busch are surprisingly powerful players. Why their clout could matter

By Alison Fitzgerald

From a Milwaukee office overlooking the original Miller Brewing plant, Craig R. Reiners haggles over futures contracts for barley, the primary grain in Miller Genuine Draft beer. He also negotiates aluminum futures, because the metal is used in the millions of beer cans the company produces every year, and works out more esoteric deals, such as swaps and collars on the natural gas that fires the brewery outside his window. Reiners' job is to insulate MillerCoors from commodity price fluctuations and ultimately protect the Great American Beer Drinker from having to pay more for a six-pack.

MillerCoors and other brewers also buy massive quantities of wheat, rice, malt, sugar, and corn. The prices of all those commodities can swing wildly, so the financial products known as derivatives—hedges on whether prices will rise or fall—help the brewer lock in a price range that smooths profits. Now the Obama Administration is looking to prevent another financial crisis by regulating the derivatives MillerCoors uses. Reiners says Washington can make his job a lot harder. "It's too bad we're being painted with the same brush as the people who really abused the system," he says.

Beer isn't what comes to mind when lawmakers talk about financial engineering. But MillerCoors, Anheuser-Busch, and other brewers are major users of derivatives, so they are at the center of an esoteric debate over how tightly to regulate the thriving over-the-counter derivatives trade, which occurs outside commodity exchanges. An estimated $605 trillion worth of private contracts are outstanding. This sort of financial contract was a cause of the global meltdown, with American International Group writing billions in credit default swaps, a form of derivative that insures against the failure of corporate or mortgage bonds, which went bad when housing collapsed.

THE WHITE HOUSE WOULD EFFECTIVELY REQUIRE DERIVATIVES USERS TO TIE UP THEIR CASH IN THE FORM OF COLLATERAL

The brewers are lobbying to stop a proposal by President Barack Obama that would force them to trade derivatives on a public exchange or process them through a clearinghouse—a company that executes the trade and settles the contract when it comes due. The White House would effectively require derivatives users to tie up their cash in the form of collateral, which the clearinghouses would collect. Obama says the idea would reduce the risk that cascading defaults could destabilize the financial system, helping avoid a repeat of the $182 billion bailout of AIG.

The brewers say collateral can be costly and unpredictable, changing as the market price of the underlying commodity changes and locking up millions of dollars. Reiners, along with MillerCoors lobbyist Richard Crawford, has traveled to Washington to make the case to lawmakers. "This proposal would tie up well over $100 million a quarter," he says. "That's money that's parked, and you can't use it for anything else."

In December the House exempted brewers and other end users of derivatives from the clearinghouse and collateral rules. Now the Administration is pushing the Senate, which has not yet approved a measure, to narrow this





EDDIE GUY

exemption, potentially forcing brewers to ante up collateral. The Senate Banking Committee did not exempt end users in a bill it approved last month; the beer companies hope to change that.

Beer lobbyists have met with the Senate Agriculture Committee staff several times in recent months, arguing that an exemption is justified. They will descend on Capitol Hill again in late April, now that the Senate is about to debate derivatives on the floor as part of the financial regulation bill. "We didn't cause the problem," says Dorothy Coleman, vice-president for tax policy at the National Association of Manufacturers (NAM). "This isn't speculating. We're not making money off these transactions."

As part of their pitch, the brewers remind lawmakers that they buy billions of dollars of farm commodities and employ thousands of union workers. The brewers are planning to come with handouts showing the impact of their industry on each state, says one industry official involved in the congressional visits. The handout for Iowa, for example, shows the beer industry was responsible for 14,325 jobs and $704 million in economic activity in the state in 2008.

Anheuser-Busch controls almost half the U.S. beer market and operates a dozen breweries. It owns 11 distributors and works with 600 independent wholesalers. It buys rice in Arkansas and California, grows hops in Idaho, and makes glass bottles in Texas. MillerCoors, which controls about 30% of the U.S. market, brews in nine states. It buys all its corn and most of its barley—some $500 million a year—in the U.S.

The brewers are also generous donors. Anheuser-Busch's political action committee and employees have given $471,000 to federal candidates and political parties for the 2010 election cycle, according to the Center for Responsive Politics. MillerCoors' PAC contributed $79,000 in the same period. The National Beer Wholesalers Assn. donated $1.7 million.

Anheuser-Busch InBev had more than $1 billion in aluminum swaps, $69 million in corn swaps, and interest rate swaps—used to smooth swings in currencies—worth more than $80 billion, according to its financial statements. Anheuser-Busch officials didn't respond to calls for comment.

If aluminum swaps—primarily private contracts between two parties—were forced to go through a clearinghouse, Anheuser-Busch would have to put up as much as 6% of the cost of a contract. "If you impose margin requirements on these companies, you're either taking away their ability to manage their risk or taking away their working capital," the NAM's Coleman says. Anheuser-Busch's $1 billion in aluminum swaps would require collateral whose value could swing by $10 million a day if the price of the metal were to change 1%, says Craig Pirrong, a finance professor at the University of Houston.

Gary Gensler, chairman of the Commodity Futures Trading Commission, which oversees most swaps, says the benefit of a safer capital market outweighs those concerns. "We have a real risk that society is bearing," he says. What does that have to do with the price of beer in Buffalo? Plenty. |BW|

FINANCE

Google a Value Play? Really?

Vulcan Value Partners' new funds scout for quality companies trading at double-digit discounts



JAN FEINDT

C.P. Fitzpatrick's money management firm, Vulcan Value Partners, is named after the Roman god of fire, not the logical aliens from *Star Trek*. "Partners" is meant to reassure investors that as manager of two new mutual funds—Vulcan Value Partners Fund and Vulcan Value Partners Small Cap—Fitzpatrick is partnering with shareholders, investing his own money alongside theirs (minimum investment: $5,000, or $500 for IRAs). The 46-year-old manager has an impressive résumé: He worked for 17 years as an analyst and co-manager at renowned value-investing shop Longleaf Partners before opening his funds to investors last December. Fitzpatrick spoke with reporter Lewis Braham from Vulcan Value Partners' office in Birmingham, Ala., where a colossal cast-iron statue of the fire god has stood watch above the city since 1936.

Q: Is your style similar to that of Longleaf Partners?

A: At Longleaf we only bought stocks of companies trading for at least a 40% discount to what we saw as the intrinsic underlying value of their businesses. We would hold cash if we couldn't find enough companies to meet that criteria. At Vulcan we tend to be fully invested and try to find companies trading for at least a 20% discount. We will not compromise on the quality of the businesses we're buying.

Q: You own Google, right?

A: Google is a good example. A lot of value managers are not enamored with tech stocks. Neither are we, but Google has an incredible franchise value. Years ago people used to say "overnight it" when they sent a package, but the day they started saying "FedEx it," a franchise was born. Well, Google's franchise is so much more powerful than FedEx's because people say "Google it" not just in the U.S. but all over the world. It generates tremendous free cash flow and has a strong balance sheet. It even grew its bottom line double digits during the recession. So in our view it's undervalued.

"[WE'RE] NOT ENAMORED WITH TECH STOCKS ... BUT GOOGLE HAS AN INCREDIBLE FRANCHISE VALUE"

Q. Does having a small asset base let you invest in small caps more effectively?

A: Absolutely. For instance, a year ago we bought RCN, a fiber-optics company which had only a $185 million market capitalization at the time and traded for $4 a share. The company was recently acquired for $15 a share by a private equity firm. We would never have been able to buy such a tiny stock and make it a significant part of our portfolio if we were running billions of dollars.

Q: What other small caps do you like?

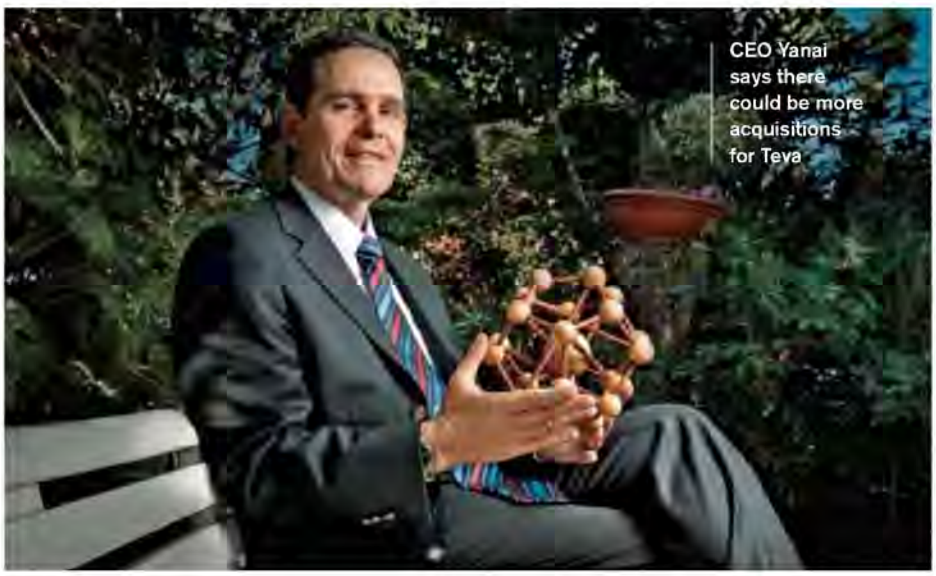
A: We like Heartland Payment Systems, a credit-card processor for small merchants. Every time someone swipes a card at a client's store, Heartland receives a small percentage of the transaction. So the company is a free-cash-flow machine. It's selling at a big discount because a year ago it was the victim of a major security breach, which sparked a class-action lawsuit. Yet the company has a strong balance sheet and even factoring in the potential costs of the lawsuit is trading at a substantial discount.

We also like Sonic Corp., a drive-in restaurant chain with a classic Americana feel. The restaurants are like the diners in that old show *Happy Days*. They have real good milkshakes and a Cherry Limeade with a cult following. I'm one of the people in the cult. The waiters roll out on skates with nice little uniforms on and always smile at you. You feel good eating there. The company had same-store sales increases for several years but had negative numbers for the first time recently because of the recession. We believe that is a temporary condition. |BW|

STRATEGY & COMPETITION

As the Pill Turns 50, A Rivalry Heats Up

With underserved markets in Asia beckoning, Teva is taking on Bayer, the leader in oral contraceptives


CEO Yanai says there could be more acquisitions for Teva

KOBI KALMANOVITZ

By Naomi Kresge

May marks the 50th anniversary of the sexual revolution sparked by a little white tablet known as the Pill. The U.S. Food & Drug Administration approved it in 1960, and the next year, German giant Bayer introduced it in Europe. Bayer profited handsomely in the ensuing decades, tweaking its contraceptive formula and extending its patents. Even in 2009—with the global contraceptive market awash in cheap generics—the company pulled in about $1.7 billion on its branded birth control pills, Yaz and Yasmin.

Now, Bayer faces competition of a different magnitude. Teva Pharmaceutical Industries, the Israeli generic drugmaker known for its Pac-Man-like acquisitions of smaller competitors, aims to triple its annual sales in the category of women's health to $1 billion as early as 2012. A large portion of the $650 million Teva needs to reach that goal is likely to come from birth-control products the company acquires in future deals.

CEO Shlomo Yanai told analysts earlier this month that Teva has its eye on several targets, though he didn't name names. Frances Cloud, an independent London-based analyst who has covered the drug industry for 23 years, says Teva could be looking at the women's health divisions of U.S.-based Merck or Abbott Laboratories. "We wouldn't rule anything out," says Bill Marth, chief executive of Teva's North American operations.

In 2008, Teva spent $7.4 billion to acquire Barr Pharmaceuticals, the top U.S. generics company, which makes Plan B, the so-called morning-after contraceptive. Last month, Teva strengthened its grip in Europe by snapping up Germany's generics leader, Ratiopharm, for just under $5 billion.

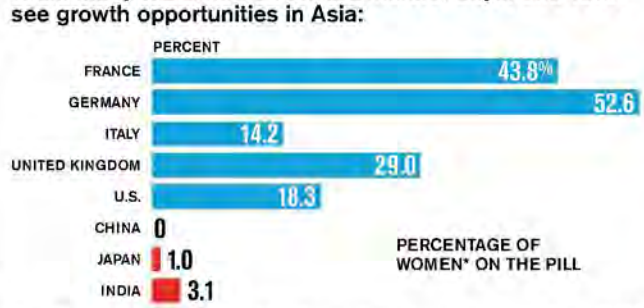
Future battles are looming in the underserved markets of the Far East. In 2007 the U.N. carried out a worldwide contraception survey of women between the ages of 15 and 49 who were married or in committed relationships. In Japan only 1% reported using the pill; in China, the percentage was so low that the data wasn't usable. Advanced Western countries presented a different picture. About 18% of American women used the Pill. The results for Germany and France were about 53% and 44%, respectively.

Bayer is still strong in women's health and aims to be a player in Asia. Including birth control, its 2009 sales in this sector topped $4 billion. In May, Bayer hopes to get U.S. approval for Qlaira, a next-generation Pill that delivers the same estrogen hormone found naturally in women's bodies. Sales could peak at about $680 million a year, says Phil Smits, head of the company's women's health unit. Not a huge number, but "we'd be foolish to walk away," he says.

With $13.9 billion in sales last year, Teva is just one-third as large as its German competitor. But in generics, a $500 million product "moves the needle" says Teva's Marth. "For us, that's attractive. For the Pfizers of the world and the Glaxos of the world, that's the bottom of their cutline." | BW |

WHO'S ON THE PILL

While many Western markets are mature, Bayer and Teva see growth opportunities in Asia:



Data: The U.N. *Age 15 to 49 and married or in long-term relationships in 2007



TOMOHIRO OHSUMI/BLOOMBERG

Eisai's Okada plans to cut prices for Alzheimer's drug Aricept in six Asian nations

STRATEGY & COMPETITION

Looking East, Big Pharma Cuts Prices

Drugmakers are beginning to choose sales volume over high margins to tap the massive Asian market

By Kanoko Matsuyama

When the pharmaceutical industry maps the world, here's what it sees: 87% of its $773 billion in revenue comes from the U.S., Europe, and Japan, but sales in those places are stagnant, according to research firm IMS Health. So where is growth to be found? The obvious answer is the rest of Asia, which is home to about 60% of the world's people—with rising rates of cancer, heart disease, diabetes, and stroke—but spends only as much on medicine as Japan alone.

The barrier, for millions of Asians, has always been the prohibitive cost of pharmaceuticals. Now, for the first time, Eisai, GlaxoSmithKline, and Sanofi-Aventis are slashing prices throughout Asia to spur demand. Yasushi Okada, Eisai's head of operations in Asia, Oceania, and the Middle East, said his company will begin with price cuts in at least six Asian countries on Aricept, the world's best-selling Alzheimer's medicine. Okada didn't specify the size of the cuts Eisai will make, but said he expects sales volume to more than make up for price reductions. "With the current prices, only a part of the wealthy people can afford to buy our products," Okada told Bloomberg News. "I want to increase the patient accessibility of the medicines in Asia."

"WITH THE CURRENT PRICES, ONLY ... WEALTHY PEOPLE CAN AFFORD TO BUY OUR PRODUCTS," SAYS AN EISAI EXECUTIVE

The first such move came last year, when Glaxo said it would reduce most of its drug prices in emerging markets to less than two-thirds of the levels in Western countries, and charge 25% of Western prices in the 50 poorest nations. The company now forecasts sales growth of as much as 10% in the Asia-Pacific region this year, after last year's 9% increase. In January, Sanofi announced price cuts in Southeast Asia that could help patients save as much as half of the price of some drugs, such as the cancer treatment Taxotere.

The price cuts aren't likely to have an impact on overall public health, according to Shanthi Mendis, the World Health Organization's coordinator of prevention for noncommunicable diseases. "The price reduction of branded drugs will benefit a fraction of the people," Mendis said.

With a combined $90.8 billion in drug sales, Asia, Africa, and Australia have obvious growth potential. Seventeen economies, led by China, India, Russia, and Brazil, will together expand pharma spending by $90 billion in the five-year period that began in 2009, according to IMS. China's drug demand alone will grow $40 billion in the period, according to an IMS report on "pharmerging" economies. It predicted they will account for more than 20% of global sales by 2013, up from 16% in 2008.

For Big Pharma, the idea is to replace sales that will be lost in the U.S. as blockbusters go generic. From 2011 through 2016, patents will expire on 18 of the world's 20 biggest medicines, according to Tim Anderson, an analyst at Sanford C. Bernstein. Those products have $80 billion in annual sales—a number almost as eye-popping as the projected sales increases in the pharmerging economies. |BW|

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Dean Rangnekar on the Indian School of Business campus in Hyderabad

MANAGEMENT & LEADERSHIP

Building a Wharton for Emerging Economies

The Indian School of Business aims to be the best at teaching how to manage in developing markets

By Bruce Einhorn

Sumit Kumar's career was going well in the U.S. After earning a master's degree in biomedical engineering at University of California at Los Angeles and working for a life-sciences consultant in Philadelphia, the 26-year-old native of the eastern Indian state of Bihar decided it was time for business school. Instead of looking at top-ranked U.S. programs, he chose to apply to only one place, the Indian School of Business (ISB) in Hyderabad. "India is a hub for the kind of stuff I do," says Kumar, who arrived on campus to start the new school year in mid-April.

Dean Ajit Rangnekar is counting on students like Kumar to propel ISB into the big leagues of global business schools. Although it opened its doors only nine years ago, the privately funded ISB is No.1 in India, and Rangnekar believes students and professors interested in business in developing countries will help it rival the world's elite schools. "Globalization 3.0 is going to be all about emerging economies," he says. "We should be known as the best" in such markets, he adds.

Located in a Hyderabad suburb that's also home to a Microsoft research center, ISB is a world away from the dirt and noise of most urban schools in India. The academic complex of pink Jaipur stone sits on a lush campus dotted with magenta bougainvillea and inhabited by peacocks and other birds. The school's 577 students must work two years before applying for the $40,000, 12-month course.

ISB gets seven applications for each slot, so it is building a second campus in Mohali in Punjab. The $50 million project is funded by donors including telecom tycoon Sunil Bharti Mittal. When it opens in 2012 the campus will specialize in infrastructure management, manufacturing, and other subjects relevant to emerging economies. On Apr. 3, Massachusetts Institute of Technology's Sloan School of Management signed an agreement to rotate in faculty for ISB, which also has teamed up with Wharton and the Kellogg Graduate School of Management.

ISB is forging a reputation for advising development projects. Reuben Abraham, a Columbia University PhD, runs its Centre for Emerging Markets Solutions, a think tank that works with a $17 million Indian venture fund backed by George Soros, eBay founder Pierre Omidyar, and Google's charitable arm. Abraham is helping developers come up with business models to provide low-cost housing to slum dwellers. ISB can take more chances than its established rivals, says Abraham, "for the simple reason we have no legacy."

The school attracts recruiters from multinationals such as IBM and Procter & Gamble but finds it hard to lure permanent faculty from overseas. ISB has only 40 full-time professors. Many others want to teach short stints but don't want to relocate to India. Says Rangnekar: "Within the walls of the campus, I can give them a better environment. But outside, I struggle." |BW|

–With Alison Damast in New York

MICHAEL RUBENSTEIN/REDUX

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PERSONAL BUSINESS

MONEY REPORT

O CANADA



HANNIBAL HANSCHKE/EPA/CORBIS

Canadian bonds are attracting record foreign investment as U.S. buyers seek to tap into the sounder finances and healthier economy of their northern neighbor. In the year ended Jan. 31, net foreign inflows into Canadian bonds were Canadian $86.3 billion (U.S. $85.9 billion), the most for a 12-month period since at least 1988, according to Statistics Canada, the country's statistical agency. Some 75% of inflows came from U.S. investors. "Canada is increasingly viewed as a store of value in its own right, with deeper, more liquid markets than before," says Michael Woolfolk, senior currency strategist at Bank of New York Mellon. Of mutual funds with 10% or more in Canadian fixed-income securities, Morningstar's top-ranked funds (four of five stars) are from Loomis Sayles. The Loomis Sayles Fixed Income fund has almost 21% in Canada and an average credit quality of BBB; Loomis Sayles Investment Grade Fixed Income has about 18% and an average credit quality of A. *–Matt Walcoff and Suzanne Woolley*

TRADING

MON(EY)DAY

On Wall Street, Monday is the best day of the week. The S&P 500 index climbed 12% from Oct. 9 through Apr. 9, reaching an 18-month high. If Mondays were left out, the S&P 500 would be little changed.

Monday has produced average advances of 0.55%, compared with an average 0.29% loss on Fridays, the worst day, according to data compiled by Bespoke Investment Group. Research sent to the firm's clients noted that "If this keeps up, 'a case of the Mondays' will end up being a good thing on Wall Street." The S&P has risen on Monday 80% of the time during the past six months, compared with 52% for Friday. The index averaged gains of 0.17% and 0.05% on Tuesday and Wednesday, respectively, and a 0.04% loss on Thursday. *–Lu Wang*

THE S&P 500 SINCE OCTOBER

DAY OF WEEK	DAYS	UP DAYS	PERCENT OF UP DAYS	AVERAGE CHANGE
Monday	25	20	80%	0.55%
Tuesday	26	15	57.7	0.17
Wednesday	26	17	65.4	0.05
Thursday	25	14	56	-0.04
Friday	23	12	52.2	-0.29
All	125	78	62.4	0.09

Data: Bespoke Investment Group

STOCKS

PEPPING UP PEP BOYS

Morgan Joseph equity analyst Jeffrey Blaeser expects shares of Pep Boys—Manny, Moe & Jack to reach 15 over the next year. The automotive retailer and service chain now trades at 11. On Apr. 8, Pep Boys reported fourth-quarter earnings per share of 4¢, vs. a 63¢ loss per share a year ago. In an Apr. 9 research note, Blaeser says that the chain's expansion strategy appears on track and that the opening of potentially higher-margin locations should gradually improve margins companywide. He hiked his fiscal 2011 (ending January) EPS estimate to 55¢ from 48¢. *–S.W.*

ESTATE TAXES

TROUBLE FOR HEIRS

By Amy Feldman

For some time, people have been making morbid jokes about bumping off their rich relatives in 2010, a year that has no federal estate tax. The George W. Bush-era law that lowered the tax contained a one-year gap that Congress has never gotten around to fixing. The tax is set to return, at a 55% rate, on Jan. 1, 2011.

Few are laughing about it now. While heirs of the ultra-rich who die this year may enjoy an estate tax break (17,172 taxable estate tax returns were filed in 2008, according to IRS data), this gap year is having an unintended consequence. Far larger numbers of affluent families who suffer deaths this year could wind up paying stiff capital-gains taxes on inheritances. That's because of the disappearance of what's known as the "step-up" in basis, which allowed assets to be revalued for tax purposes at the time of death. "Many people are going to be worse off than before," says Clay R. Stevens, director of strategic planning at Aspiriant, a Los Angeles wealth-management firm. "If you've only read the sound bites, you've been misled."

Under last year's rules, estates below $3.5 million (or $7 million for a couple) were exempt from the estate tax; people above those limits were hit with rates as high as 45%. Crucially, assets were revalued at the time of death—"stepped up" to their full current value and not subject to capital-gains tax on past appreciation. When the estate tax went on hiatus, the "step-up in basis" rule for valuing assets went, too, so heirs are suddenly liable for capital gains on the past appreciation of assets they inherit and sell. For those who are bequeathed homes that have grown in value, family businesses that have expanded, or stocks that have risen in price, the old "step-up" rule let them start with a clean slate, owing no capital-gains taxes when they sold the assets. Not anymore.

An executor can now assign a "step-up" basis of up to $1.3 million to assets in the estate, and an additional $3 million for assets left to a surviving spouse. Many affluent families that have held assets for decades will bump up against those limits. Consider someone who inherits from their widowed father a home purchased for $100,000 decades ago that is now worth $2.5 million. Under last year's rules, assuming that was the only asset in the estate, there would have been no tax due because the estate would have been below the exemption amount. This year there would be no estate tax due either, but there would be capital-gains tax due on the $1.1 million in gain above the allocated step-up—$165,000 at the current 15% federal rate.

Things get more complex when family dynamics come into play. If there are multiple assets going to multiple heirs, the executor must choose how to allocate that $1.3 million in tax basis among the assets, a Solomonic task. "It may be applied so that it doesn't equally

WILLS THAT WON'T

By Amy Feldman

There's another possible unintended consequence of the estate tax hiatus: accidentally disinheriting your heirs. That's because one traditional way of writing wills was to specify that a sum equal to the legal tax exemption ($3.5 million last year) would go to the kids, either directly or through a trust. It was a tax-savvy way of divvying up estates. With no estate tax for 2010, however, the exemption is essentially unlimited. If the exemption is unlimited that means there's no longer any divvying up of the estate, and wills written this way could unintentionally disinherit beneficiaries. "The question is, does the will still mean what you want it to mean? Frequently, the answer is no," says Michael Gooen, an estate attorney at Lowenstein Sandler in Roseland, N.J. To avoid such a fight, estate attorneys suggest that people, especially the elderly or ill, review their wills and rework them to clarify their meaning in a year without estate tax. That might mean specifying a maximum dollar amount that goes to the kids rather than relying on the exemption as the implicit amount, or making changes to the structure of the trusts. "People have to put Band-Aids on their wills," says Christopher Zander, a partner at Evercore Wealth Management.



PAUL BLOW

benefit all beneficiaries," Aspiriant's Stevens says. "You have to say, 'I'm giving you this asset and you get the step-up in basis, but I won't give it to that asset.' So two beneficiaries could receive the same fair market value of assets, but different amounts of aftertax value."

Take that example a step further. Assume that in addition to the $2.5 million house, there's $2.5 million in IBM stock, bought for $500,000. If the house goes to the deceased's daughter and the stock to the son, the two would seem to get equal amounts. But because the daughter will owe more capital gains when she sells the house, she has actually received less—unless the executor allocates a larger portion of the step-up in basis to offset it.

Brent R. Brodeski, managing director at Rockford (Ill.) wealth-management firm Savant Capital Management, outlines a scenario where one adult child inherits a family business worth $5 million, with a tax basis of $1 million, and the other inherits $5 million in cash. Last year those bequests were equivalent in value. But without the step-up, the family business has an embedded capital gain that would be due at the time of the sale. Even if the executor allocated all of the $1.3 million to the business, that would still be the case, since there's $4 million in appreciation. "Does that mean that you have to look at the family business net of tax, and the kid with the cash has to ante up to the kid with the business?" Brodeski asks. "The kid with the cash says, 'My brother doesn't want to sell it, so I don't want to give him a bonus.' And the kid with the business says, 'I don't know if I want to pass it down to my kids, I might want to sell it.' How do you resolve that debate?"

These questions fall to executors, who face potential lawsuits from disgruntled heirs. There's also a record-keeping nightmare: tracking capital improvements parents made to a home or determining all the stock splits that occurred in a stock over 50 years. Estate attorneys are urging children of elderly parents who expect to inherit property that has substantially appreciated to ask parents to gather records now.

Last year the conventional wisdom was that Congress would fix the estate tax problem before yearend. More than three months into 2010, it's clear that even if Congress fixes the rules, it won't happen fast enough to forestall some families' estate tax hell. "I imagine we'll have decades-long court battles over it," says Brodeski. "It's a big, fat mess." |BW|

LIFE MANAGEMENT

SECOND ACTS

RETIRED—BUT IN THE GAME

By Laura Lallos

Some workers think of retirement as the day they'll close the door and walk away from their jobs forever. Not so the scientists and engineers who have signed on with YourEncore, a Web-based service that connects retirees with companies that need their expertise.

The service, headquartered in Indianapolis, allows the more than 50 member companies to tap into advanced professional skills as needs arise. For the more than 5,000 retirees who have signed on, YourEncore provides a way of continuing to work and generate income with time left over to "become a better golfer and fisherman," as Phil Bross, a former Procter & Gamble analytical chemist, puts it. Bross, 58, started working with YourEncore in 2008, two years after he retired. He enjoys "the luxury of working 10 to 20 hours a month on innovative projects with experts from a variety of businesses."

YourEncore was founded in 2003, after Procter & Gamble and Eli Lilly asked consultant John Barnard to devise a way to draw on the expertise of their retired employees. Barnard, who had retired from Lilly, joined forces with Brad Lawson, now YourEncore's CEO, and Tim Tichenor, now CFO, to start the venture with backing from angel investors. Boeing soon signed on, then General Mills, which has a small equity stake. Lawson won't disclose revenue but says the business has grown about 50% per year over the past six years.

Participating companies pay membership and network access fees, which vary by the size of the company and how it is using the service. They work with YourEncore account managers to define projects and recruit the best experts for each job. Pay depends on an expert's experience and the company in question. Retirees can negotiate a fee for an entire project or bill on a daily or hourly basis.

Lilly uses YourEncore on 75 to 100 projects a year "for research and development, to gain diversity of thought," says Jim Grace, senior director of operations at Lilly Research Laboratories and a liaison with YourEncore. As Lawson explains it, a company such as P&G can "leverage the experience of a systems engineer from Boeing to apply virtual computer modeling to design diapers." If a company anticipates a need for, say, a team of aseptic package specialists in two months, YourEncore will vet candidates and have a team ready to go. YourEncore's Innovation Community, a Web-based tool that lets companies post problems confidentially and receive solutions from experts, is increasingly popular, says Lawson. Experts can showcase their skills and may receive compensation for solutions.

RECONNECTING WITH COLLEAGUES

Tim Bohrer, a 60-year-old chemical engineer, runs his own consulting firm from his home office in Chicago. He has done nine projects through YourEncore in the past year. "It's been stimulating and fun working with other experts on important projects," says Bohrer, who does not consider himself retired and who worked at several companies before starting his firm in 2003. "I can reconnect with past colleagues, and it is even more exciting to meet new people I had not run into in my career."



Bohrer has done nine projects through YourEncore in the past year

RUDY ARCHULETA/REDUX

Lawson says a growing number of YourEncore applicants are pursuing full-time alternative careers as independent consultants. But even the retirees aren't technically retired, he notes. "To retire means to disengage, to withdraw. You don't see that much anymore. Our experts are 'post-employment' but still professionally active." |BW|


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68 Outside Shot: Making financial literacy the new civil right



BOOKS By JAMES PRESSLEY

Too Big To Prevail?

MIT's Simon Johnson and co-author James Kwak deliver a harsh take on U.S. banking

Alan Greenspan, the master of monetary mumbo jumbo, leaned back in his chair and grew uncharacteristically forthright. ¶ "If they're too big to fail, they're too big," the former Federal Reserve chairman said when asked about the dangers of outsized financial institutions. ¶ It was October 2009, and the man who helped make megabanks possible was starting to sound more like Teddy Roosevelt than the Maestro as he entertained what he called a radical solution.

"You know, break them up," he told an audience at the Council on Foreign Relations in New York. "In 1911, we broke up Standard Oil. So what happened? The individual parts became more valuable than the whole."

Greenspan the bank buster crops up near the end of *13 Bankers*, Simon Johnson and James Kwak's reasoned look at how Wall Street evolved into what they call "the American oligarchy," a group of megabanks whose great economic power has brought them political power. Unless these too-big-to-fail banks are broken up they will cause a second meltdown, the authors write. "And when that crisis comes, the government will face the same choice it faced in 2008: to bail out a banking system that has grown even larger and more concentrated or to let it collapse and risk an economic disaster."

The banks in their sights include Bank of America, JPMorgan Chase, and Goldman Sachs. Though Wall Street may not like *13 Bankers*, the authors can't be dismissed as populist rabble-rousers. Johnson is a former chief economist for the International Monetary Fund who teaches at the Massachusetts Institute of Technology's Sloan School of Management. Kwak is a former McKinsey consultant and software entrepreneur. In September 2008 they started Baseline Scenario, a blog that quickly became essential reading on the crisis. When they call Wall Street an oligarchy, they're not using the term loosely.

Drawing parallels to the U.S. industrial trusts of the late 19th century and Russian businessmen who rose to economic dominance in the 1990s, the authors apply the term to any country where "well-connected business leaders trade cash and political support for favors from the government."

Oligarchies weaken democracy and distort competition. The Wall Street bailouts boosted the clout of the survivors, making them bigger and enlarging their market shares in derivatives, new mortgages, and new credit cards, the authors say.

These megabanks emerged from the meltdown more opposed to regulation than ever, the authors say. If they get their way—and they just might, judging from current congressional maneuvering over President Barack Obama's proposed regulatory overhaul—Wall Street will retain its license to gamble with the taxpayer's money. This isn't good for anyone, including the banks themselves, which often feel compelled by competitive pressure to take suicidal risks.



13 Bankers: The Wall Street Takeover and the Next Financial Meltdown **by Simon Johnson and James Kwak; Pantheon; $26.95; 304 pp**

"There is another choice," Johnson and Kwak propose: "the choice to finish the job that Roosevelt began a century ago, and to take a stand against concentrated financial power just as he took a stand against concentrated industrial power."

Obama finds himself in the middle of a



White House, Mar. 27, 2009: *13 Bankers* rails against the megabanks' clout

MARK WILSON/GETTY IMAGES

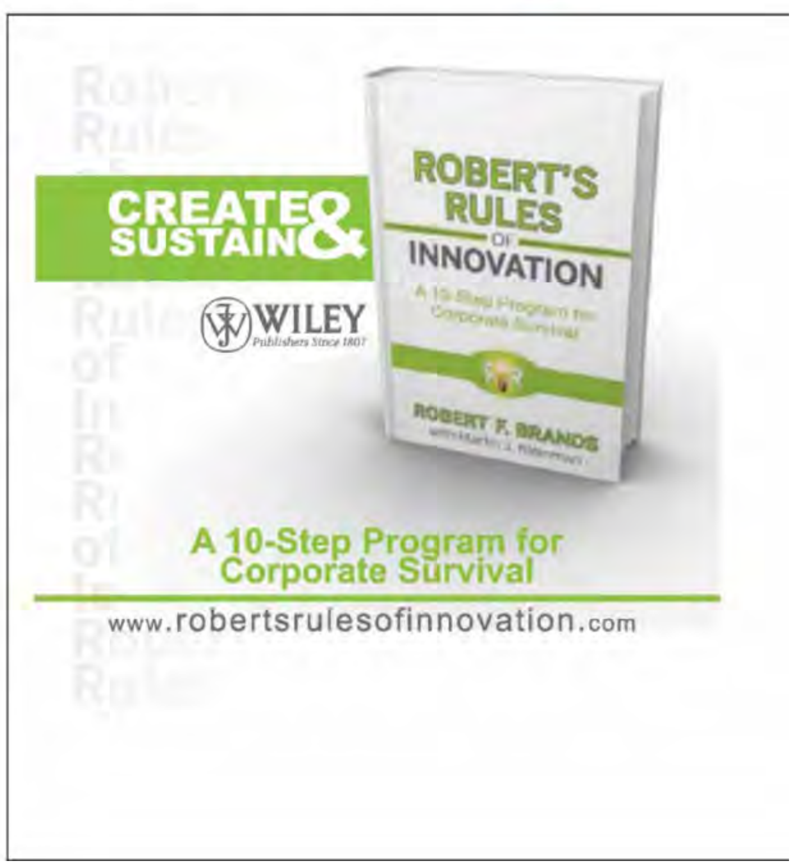
struggle that has coursed throughout U.S. history—the struggle between democracy and powerful banking interests. The book's title alludes to one Friday morning in March 2009 when 13 of the nation's most powerful bankers met with the President at the White House amid a public furor over bailouts and bonuses.

The material that sets this book apart can be found at the beginning and end. Chapters three through six present an all-too-familiar, though meticulously researched, primer on how the economy became "financialized" over the past 30 years. Students of the crisis won't miss much if they skip ahead to the last chapter, where the authors debunk arguments that curbing the size of banks is too simplistic a solution. A more complex approach, Johnson and Kwak counter, would invite "regulatory arbitrage, such as reshuffling where assets are parked."

In a nutshell: They propose that no financial institution should be allowed to control or have an ownership interest in assets worth more than 4% of U.S. gross domestic product, or roughly $570 billion in assets today. A lower limit should be imposed on investment banks—effectively 2% of GDP, or roughly $285 billion, they say.

If hard caps sound unworkable consider that these ceilings would affect only six banks: Bank of America, JPMorgan Chase, Citigroup, Wells Fargo, Goldman Sachs, and Morgan Stanley. "Saying that we cannot break up our largest banks is saying that our economic futures depend on these six companies," they conclude. "That thought should frighten us into action." Though Jamie Dimon, Vikram Pandit, and Lloyd Blankfein won't appreciate this sort of backtalk (any more than John D. Rockefeller did), incremental regulatory changes are not likely to change the underlying situation. As Johnson and Kwak see it: "If there are no banks that are too big to fail, there will be no implicit subsidies favoring some banks over others."

So why does their sensible proposal now seem so wildly ambitious and unachievable? Whatever happened to Greenspan the bank buster? |BW|



FEEDBACK

OBAMANOMICS

TURNING A BLIND EYE TO DEBT?

Having a master's degree in business, I can say with complete confidence that "Why the Obama Plan Is Working" (In Depth, Apr. 19) is utter rubbish. Crediting the market's temporary uptick to Obama's policies is asinine. All businesspeople know the market is all about short-term profit. It is unclear where the market and economy will be at the end of the year. What is not unclear is the increasing debt this Administration has placed on future generations. This Administration is on par to double the debt of all previous Administrations. Mike Dorning can cheerlead for Obama all he wants, but he takes away not just his credibility but that of *BusinessWeek* when he does.

Michael Buck
CARROLLTON, TEX.



PATENTS

A RECOUNT ON PATENT MONITORING

"CEO Guide to Patent Trolls" (businessweek.com, Feb. 1) contained numerous references made to data produced by PatentFreedom. PatentFreedom conscientiously researches data it provides to its subscribers and the broader public related to the activities of so-called Non-Practicing Entities (NPEs).

As the articles acknowledge in certain sections, the term "patent troll" is almost always problematic. While many use it without malicious intent as shorthand for an entity that primarily enforces patents, the term is certainly loaded and some consider it pejorative. Plus, it can lead to confusion. We prefer the more neutral Non-Practicing Entity (NPE).

We define NPEs as entities that derive a substantial portion of their revenue from licensing or enforcing patents and for which we have been unable to obtain verifiable evidence that the entity sells products or services that would make it vulnerable to patent counter-assertion. We intend to provide potential licensees of patents held or enforced by such entities with knowledge that may help in their discussions with them.

In one article in the report, *BusinessWeek* writes that Acacia Research has filed more than twice as many litigations as Rates Technology (RTI), "which ranks second in the number of patent cases filed, according to PatentFreedom." That statement is incomplete. RTI maintains it is not an NPE because it produces substantial revenue from the sale of products and services beyond the enforcement of its patents. While PatentFreedom has been unable to independently confirm RTI's statement, additional analysis indicates clear and important differences between RTI and NPEs such as Acacia.

First, RTI is the original owner of the two patents it is enforcing and the two it has enforced in the past (which have expired). Moreover, RTI President Gerald J. Weinberger is one of the inventors on each of these patents. This is clearly distinguishable from many NPEs that primarily—or exclusively—base their enforcement activities on patents either purchased from others or from which they have obtained enforcement rights.

Further, unlike many NPEs that file litigation against many operating company defendants simultaneously, RTI enters into discussions with companies to try and persuade them to pay a one-time fee in exchange for a covenant not to sue. If these discussions are not fruitful, RTI has turned to the courts to pursue the matter, but most frequently one company at a time. Therefore, while RTI has sued approximately 60 companies since 2000, in terms of the number of defendants sued, it ranks 17th among entities PatentFreedom tracks, not second.

Since 2007, RTI has sued approximately 15 companies, some of which they state were filed to obtain jurisdiction in New York should settlement discussions fail to conclude in a timely manner (and which were dismissed a few months after filing). In that same period, Acacia has brought patent lawsuits against more than 500 companies.

Daniel P. McCurdy
CEO
PatentFreedom
NEWTOWN, PA.

CORRECTIONS & CLARIFICATIONS

"Getting Out of Citi" (The Week in Business, Apr. 12) contained a mathematical error. The profit the U.S. Treasury would realize from the sale of its 7.7 billion common shares of Citigroup would amount to $6.2 billion, based on the stock's Mar. 31 closing price.

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INDEX OF COMPANIES AND PEOPLE

The index lists significant references to companies, top executives, public officials, and well-known figures around the globe. The folio denotes the first page of the story containing the reference.

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OUTSIDE SHOT

By JOHN HOPE BRYANT

A Type of Learning That Pays Dividends

Making financial literacy a new civil right will give millions of Americans a shot at prosperity and do the U.S. economy a world of good

Even now, as the dust from the financial crisis settles, there's surprisingly little agreement on what just happened. As the banks, mortgage brokers, financial-products innovators, and regulators argue over who deserves more blame, it's obvious that a vast number of American consumers were simply out of their league. They spent more than they earned, willingly signed up for trip-wired housing loans, and piled on debilitating levels of credit-card debt.

If you're reading this, you're probably fluent in the language of money. But as the Federal Deposit Insurance Corporation announced late last year, more than 25% of U.S. households are unbanked (with no accounts at all) or underbanked (making use of alternative financial services such as check-cashing services and payday lenders). Even before the crisis hit, 70% of Americans were living from paycheck to paycheck. Those among us who were never taught the fundamentals of money are living at a huge disadvantage in this increasingly complex age. But there's a way to change that: Make financial literacy the next civil right. If this handicap were to fade, a very real drag on the entire economy would be lifted. As a side benefit, predatory lenders would have to find a new line of work.

In order to fix this problem, we need to quantify and track it, which is why Operation HOPE, the financial literacy nonprofit I founded, teamed with Gallup to begin to meet this need. The Gallup-HOPE Financial Literacy Index, first announced on Apr. 7, will build on the Gallup Student Poll of over 70,000 participants in grades 5 through 12 in 18 different states to yield hard data on how many American youths have held a job or a savings account. It will tell us how many have a general understanding of what it takes to run a business and how many hold a positive view of free enterprise and envision themselves taking part in it.

A comprehensive plan to raise financial IQs began taking shape in early 2008 under President George W. Bush, prior to the financial crisis. President Barack Obama reinforced it by creating the President's Advisory Council on Financial Capability, and the Education Dept. will be promoting a financial component in the curriculum for all public school students from kindergarten on up (although there are limits on its influence). In addition, a bill now before Congress would require the recipient of every guaranteed student loan to take a course in financial literacy, and every college that gets federal funds would have to offer one.



The challenge of boosting financial literacy has to be addressed in the marketplace and at the local level, too. Operation HOPE has negotiated a landmark five-year commitment from the Financial Services Roundtable—boasting a membership of 41 banks and a host of asset management companies and insurers, among others—to promote fairer financial products and efforts to raise literacy.

Some of the ideas coming out of this effort promise to be genuinely transformative. Here's just one: a fixed-rate mortgage with a built-in "life-event" clause that gives the holder the right to a one-month grace period in return for every 18 months of on-time payments. That would mean that a lost job wouldn't have to spell disaster in a single-income household.

If you're born in the U.S. you get a Social Security number. When we're ready to take the idea of financial literacy as everyone's right seriously, perhaps we'll also start assigning an electronic debit card at birth that's tied to an account covered by the FDIC or the National Credit Union Administration. This idea certainly won't go over well with the owners of check-cashing businesses, but it would, over time, take the unbanked portion of the population and put it on the financial map. And that's a great place for all of us to be. |BW|

John Hope Bryant is the founder and chairman of Operation HOPE and the author of Love Leadership: The New Way to Lead in a Fear-Based World.

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